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P A P E R

MAY 2005

**The Effects of
Reserve Call-
Ups on Civilian
Employers**



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Note

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Preface

T

he ability of reservists to contribute to national defense depends in part on the support of their civilian employers. The current trend toward longer and more frequent reserve deployments, however, raises questions about the ability of civilian employers, particularly small businesses, to absorb the costs they experience when their reservist employees are called up. This Congressional Budget Office (CBO) paper, which was requested by the Chair of the Senate Committee on Small Business and Entrepreneurship, examines the implications of reserve call-ups for civilian employers and considers measures that might alleviate problems that businesses face. In keeping with CBO's mandate to provide objective analysis, the paper makes no recommendations.

The report was prepared by Heidi L. W. Golding of CBO's National Security Division under the supervision of J. Michael Gilmore and Matthew S. Goldberg. David Brauer, Arlene Holen, Carla Tighe Murray, Jennifer Smith, Ralph Smith, Jo Ann Vines, and Tom Woodward provided helpful comments on a draft of the analysis, as did external reviewer Glenn Gotz. (The assistance of external reviewers implies no responsibility for the final product, which rests solely with CBO.)

Leah Mazade edited the paper, and Janey Cohen proofread it. Maureen Costantino prepared the report for publication and designed the cover. Lenny Skutnik printed the initial copies, and Annette Kalicki and Simone Thomas prepared the electronic version for CBO's Web site (www.cbo.gov).

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CONTENTS

Summary and Introduction 1

- CBO's Findings 2
- Options for Mitigating the Effects of Reservists' Activations 2

An Overview of the Reserves 3

- Organization 3
- Selected Demographic Data 5
- Employment Profile 6

DoD's Use of the Reserves 8

- Recent Mobilizations 8
- DoD's Plans for the Future 10

How Reservists' Call-Ups and Federal Protections Affect Employers 12

- Effects of Job Vacancies 12
- Effects of Uncertainty About the Timing and Duration of Call-Ups 12
- Effects of USERRA on Employers' Labor Costs 13

CBO's Analysis of the Distribution of Businesses' Losses from Reservist Call-Ups 15

- Data from Interviews 15
- Findings 16

Options for Alleviating Businesses' Costs for Reservist Activations 20

- Effects on Stakeholders 20
- Potential Alternatives 22

Appendix: Reservists' Protections Under Federal Law 29

Figures

1.	Organization of the Military Reserves	4
2.	Selected Reservists by State, 2004	6
3.	Selected Reservists as a Proportion of a State's Population	7
4.	Civilian Employers of Selected Reservists, 2004	8
5.	Civilian Occupations of Selected Reservists, 2000	9
6.	Annual Active-Duty Days per Ready Reserve Member	10

Boxes

1.	Selected Legal Authorities for Mobilizing the Reserves	5
2.	The Continuum of Service	11
3.	State Initiatives	21



The Effects of Reserve Call-Ups on Civilian Employers

Summary and Introduction

The military reserves provide trained service members and units that are available for active military duty during peacetime and war.¹ Over the past decade, the Department of Defense (DoD) has dramatically increased its reliance on the reserve forces, particularly since the terrorist attacks of September 11, 2001. The reserves are integral to current operations—of service members deployed in November 2004 in Iraq and Afghanistan, about 33 percent were reservists—and DoD foresees continued reliance on them. (Throughout this paper, “reserves” refers to the individual services’ National Guard and reserve components: the Air Force Reserve, the Air National Guard, the Army Reserve, the Army National Guard, the Coast Guard Reserve, the Marine Corps Reserve, and the Navy Reserve.)

Yet many reservists, when they joined the military, probably did not anticipate the increased frequency and duration of the activations that have occurred during the past several years and may be finding those mobilizations more disruptive than they might have expected.² To alleviate difficulties with call-ups, the Congress has enacted legislation to provide civil and employment protections and financial relief. The Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the primary legislation governing service members’ employment rights, guarantees the right of reservists to be reemployed by their civilian employer after

1. See 10 U.S.C. §10102, added by Pub. L. 103-337, Div. A, Title XVI, Subtitle C, § 1661(a)(1), 108 Stat. 2970, and most recently amended by the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Pub. L. 108-375 §511, 118 Stat. 1877.

2. Although in some contexts the terms “mobilization,” “activation,” and “call-up” may have different meanings, in this report they are used interchangeably.

serving on active duty, prohibits employers from discriminating against individuals in any aspect of employment because of their service in the reserves, and mandates some continuation of benefits to reservists who have been activated.³ By ensuring that people who are interested in military service can retain their jobs and participate in the reserve forces without fear of reprisal by their civilian employers, those provisions may also aid DoD in its recruiting and retention efforts.

The increased pace of reservist activations has focused attention on how call-ups affect the civilian employers of reservists, including reservists who are self-employed. Yet there is little information about the type and magnitude of the disruption that firms experience when their reservist employees or reservist owners are activated. As a result, the impact of call-ups on businesses has not been systematically examined.

This Congressional Budget Office (CBO) report examines the combined effects of reservists’ activations and federal job protections on civilian employers. It also addresses the question of financial losses among self-employed reservists, a group that some people maintain deserve special assistance because they may have experienced particularly negative effects from the recent rise in activations.⁴ In its analysis, CBO used survey informa-

3. Codified at 38 U.S.C. §§ 4301-4333 (2000), as most recently amended by the Veterans Benefits Improvement Act of 2004, Pub. L. 108-454, § 201-204, 118 Stat. 3606. The protections of USERRA do not apply to self-employed reservists or reservist business owners, terms that are used synonymously in this paper to refer to both incorporated and unincorporated businesses owned by reservists.

4. At many points in the discussion, the experience of reservist business owners is combined with that of other employers. At other times, the unique issues confronting self-employed reservists are treated separately.

tion collected by the Departments of Defense and Labor and by other organizations; it also interviewed reservists, manpower experts, business and reserve associations, and others. Although such data are limited and any conclusions drawn from them cannot be generalized to all employers, they provide insight into the problems that some employers are confronting.

CBO's Findings

CBO's analysis revealed that most employers are unaffected by the activation of reservists. Only about 6 percent of business establishments employ reservists, and fewer than half a percent of self-employed people are in the reserves. Among firms with reservist employees and owners, substantial variation is seen in their ability to adjust to a reservist's call-up. Activations create vacancies that firms would not otherwise have had. Some businesses may absorb the loss of personnel at little cost, but others may experience slowdowns in production, lost sales, or additional expenses as they attempt to compensate for a reservist's absence. A smaller number yet may find that they are unable to operate for lengthy periods—or at all—without their reservist and may experience financial losses or insolvency. Such problems are likely to be more severe for:

- Small businesses that lose essential (key) employees;
- Businesses that require workers with highly specialized skills; and
- Self-employed reservists.

Small businesses (generally those with fewer than 100 employees) employ about 18 percent of all reservists who hold civilian jobs; businesses with fewer than 500 employees and self-employed reservists employ about 35 percent. But there are no precise data on the number of reservists who are key employees or who have highly specialized skills. On the basis of survey information about reservists' civilian occupations, CBO estimates that out of the 860,000 reservists in the Selected Reserves (the primary source of reserve personnel), between 8,000 and 30,000 of them probably hold key positions in small businesses. In addition, about 55,000 reservists are self-employed. Considering that snapshot of reservists' employment, CBO expects that as many as 30,000 small businesses (0.6 percent of all such firms) and 55,000 self-

employed individuals (less than 0.5 percent of the self-employed) may be more severely affected than other reservist employers if their reservist employee or owner is activated.

In addition, CBO found that although USERRA provided employment protections to reservist employees, it might be exacerbating the difficulties that call-ups present for those individuals' employers. The legislation limits firms' flexibility in avoiding vacancies and imposes additional costs on some employers.

Options for Mitigating the Effects of Reservists' Activations

To help lessen the adverse effects of call-ups, two broad approaches are available: policymakers could enact legislation, or DoD could change its policies. Either approach, however, would require balancing a number of goals that sometimes conflict, such as providing reservists with a wide range of protected civilian employment, assisting DoD's efforts to recruit and retain the military personnel it requires, minimizing the value of the labor resources being diverted from the civilian economy and improving DoD's allocation of personnel, and avoiding harm to small businesses. In its analysis, CBO considered several potential measures to mitigate the undesirable effects of call-ups, evaluating the measures in terms of those goals and their effects on DoD, reservists, and their employers. Options might include:

- Compensating businesses through tax credits or direct payments;
- Subsidizing loans to employers;
- Providing or subsidizing call-up insurance for businesses; or
- Exempting certain reservists from call-ups.

The first three options, depending on how they were structured, could advance the goals listed above, including that of maintaining the legislated employment protections that reservists enjoy. The options would at least partially offset financial losses for firms that had reservist employees or owners who had been activated. In addition, the measures might increase employers' support for reservists' military service, which could in turn encourage

more individuals to either join or remain in the reserves. Moreover, if mechanisms could be developed so that DoD faced more of the costs associated with call-ups, it would then be better able to evaluate the most cost-efficient mix of reserve and active-duty personnel. In particular, it might have an incentive to recruit civilians whose absence from their positions would pose less cost to employers and thus decrease any amounts DoD might pay in compensation.

The final option features a different mechanism from that of the others: it would reduce the number or frequency of call-ups rather than compensate employers for activations that had occurred. For example, DoD could exempt certain reservists or particular civilian positions from call-ups. Employers might benefit from that option, but if it was formulated too broadly, it might interfere with DoD's efforts to provide sufficient forces for war and other military contingencies. In addition, if call-ups were limited, reservists who were eager to serve and who wanted to be activated might be less satisfied with reserve service. By the same token, reservists who found the current levels of activation too high might be more satisfied.

All of the options would assist at least some of the businesses affected by call-ups. But none of the measures are likely to completely eliminate the problems that firms face. The rules that established which businesses were eligible for assistance and the extent of that aid would determine the degree to which a particular measure reduced the losses that some reservist employers and owners incurred from a call-up.

Another consideration is that the options entail either direct or indirect costs for the federal government and, consequently, for taxpayers. Even the fourth option, which calls for limiting certain reservists' call-ups, would entail indirect costs. Declaring some individuals ineligible for activation might impede DoD's ability to mobilize sufficient personnel and might discourage participation in the reserves. DoD would then need to use pecuniary or other incentives to attract additional people to reserve service.

The direct costs of compensating businesses through tax credits or direct payments, or by offering loans or insurance—the first three options—could be substantial, depending on how a measure was structured. The more targeted a remedy is, the more cost-effective the solution

will be. That notion implies that any remuneration should be based on the actual loss that a firm experiences. However, calculating the decrease in profitability associated with call-ups may be virtually impossible. As CBO's interviews revealed, some business owners, even when they could quantify a change in profits, could not isolate how much of the decline was due to a reservist's activation and how much was due to other causes, such as a downturn in the economy, shifts in demand for the firm's products, or increased competition. Instead, the basis for compensating an employer's loss might be approximated. For example, the reservist's civilian salary or the costs of replacing the reservist could be used as measures of the firm's financial loss. Another approach would be to base compensation more broadly on the type or size of the business.

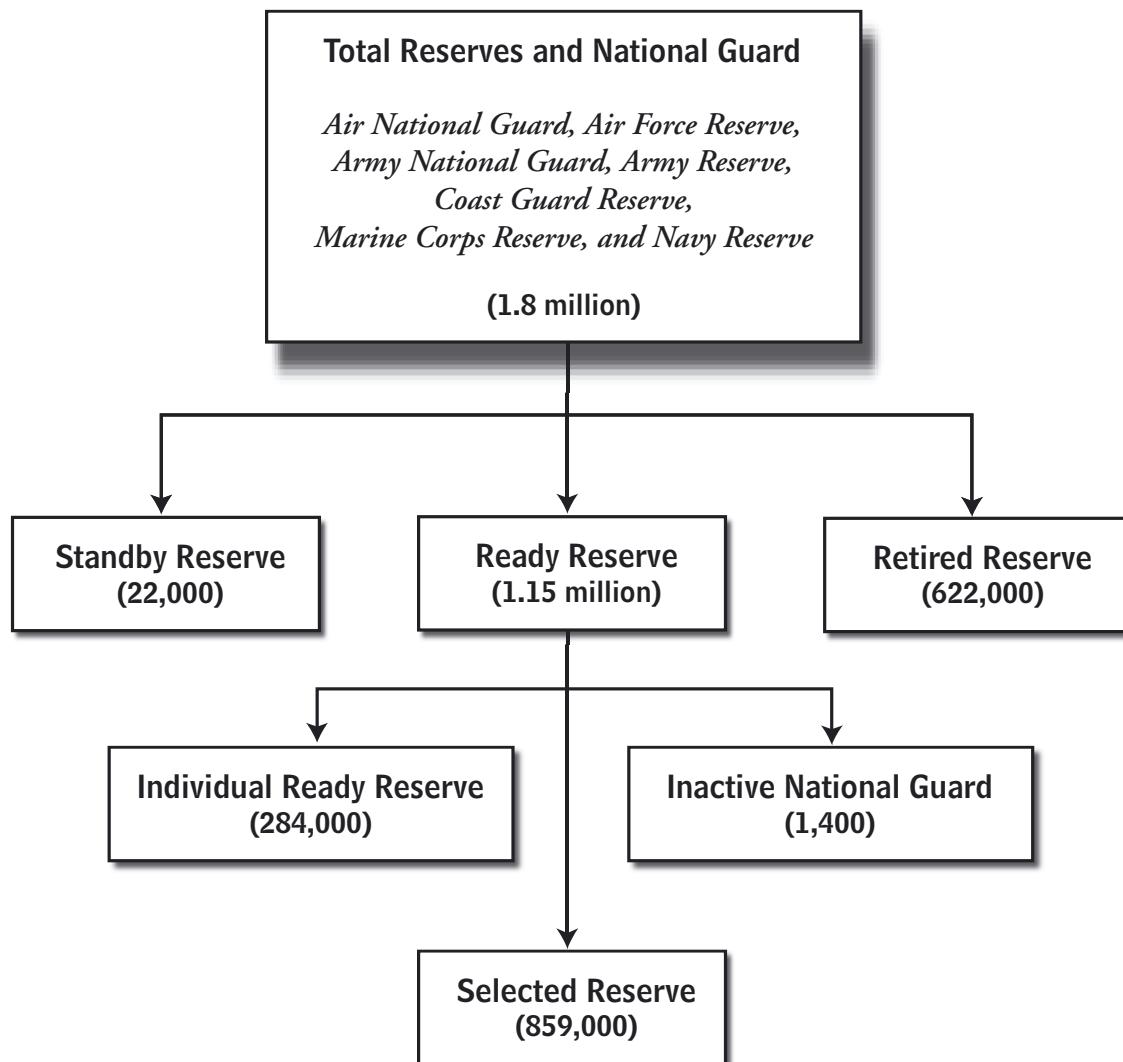
An Overview of the Reserves

The military's increased use of the reserves over the past several years has highlighted that component of the armed forces. The section that follows sketches some demographic features of this group as well as the positions they fill and the firms that employ them in the civilian sector of the economy.

Organization

The nation's military reserves, totaling 1.8 million members, are organized by service. Each service, including the Coast Guard, has a reserve component. In addition, the Air Force and Army each have a National Guard component. In general, National Guard units are organized and controlled at the state level. All states (including the District of Columbia) and all U.S. territories have both Army and Air National Guard units.

The personnel in each of those components are assigned to one of three categories: the Standby Reserve, the Retired Reserve, or the Ready Reserve (see Figure 1). Standby Reservists, who are not required to train, are generally reservists who have a temporary hardship or disability or who have been exempted for other reasons. Retired Reservists are primarily former members of the armed forces who are receiving military retired pay. The Ready Reserve, with more than a million members, is the largest component, comprising the Selected Reserve, the Individual Ready Reserve, and the Inactive National

Figure 1.**Organization of the Military Reserves**

Source: Congressional Budget Office based on data from the Office of the Assistant Secretary of Defense for Reserve Affairs.

Note: The figures in parentheses indicate numbers of reservists.

Guard. All reservists may be mobilized for national security reasons under certain circumstances (see Box 1).

Members of the Selected Reserve, which is considered essential to the initial missions that the military undertakes when the country goes to war, must be available to mobilize within 24 hours. This component of the reserves is primarily organized into units that “drill” (train) one weekend a month; in addition, members of the Selected Reserve participate in extended training for two weeks each year. Some Selected Reservists, however, support the

military in other ways. For example, Individual Mobilization Augmentees do not train with a unit except when they prepare for mobilization. By contrast, the Active Guard/Reserve comprises military personnel on full-time active duty who support the reserves in such areas as personnel administration. All active members of the National Guard are part of the Selected Reserve.

By comparison with the Selected Reserve, the other two components of the Ready Reserve participate less intensively. Many members of the Individual Ready Reserve

Box 1.**Selected Legal Authorities for Mobilizing the Reserves**

Under a Presidential declaration of national emergency (partial mobilization), an authority designated by the Secretary of Defense, as specified in 10 U.S.C. §12302, may order to active duty as many as a million Ready Reservists at one time for no more than 24 consecutive months. As specified by 10 U.S.C. §12301(a), the entire reserves, including Standby and Retired Reservists, may be ordered to active duty under a Congressional declaration of war or national emergency (full mobilization) for the duration of the war or national emergency and for six months thereafter. (However, Standby and Retired Reservists may not be ordered to active duty under a Congressional declaration unless there are “not enough qualified reserves in an active status or in the inactive National Guard in the required category who are readily available.”) The Presidential Selected Reserve Call-Up Authority, as specified at 10 U.S.C. §12304, allows the federal government to mobilize as many as 200,000 members of the Selected Reserve and the Individual Ready Reserve for no more than 270 days even without the stipulation of a national emergency.

Other authorities exist for the mobilization of reserves but are more restrictive—for example, regarding the duration of the call-up or the consent required. As an illustration, 10 U.S.C. §12301(b) allows an authority designated by the Secretary of Defense at any time to order any reserve member to active duty for no more than 15 days per year. The authority may be exercised without the consent of the reservist. However, the appropriate governors must consent to any such order for their state’s National Guard members. In addition, 10 U.S.C. §12301(d) allows an authority designated by the Secretary of Defense to order a reserve member to active duty with the consent of that member (in other words, it provides for calling up reservists who volunteer for active duty). Again, governors, or other appropriate authorities, must consent to any such order for their state’s National Guard members.

In addition to those federal authorities, the states’ governors may call up their National Guard units to help respond to domestic emergencies—typically, to participate in disaster relief efforts.

have separated from the active-duty military before their contract has expired (for example, for medical reasons) and are fulfilling the remainder of their total service obligation in the reserves. Such reservists do not perform regularly scheduled training. Members of the Inactive National Guard must meet with their unit once a year but do not participate in training.

Selected Demographic Data

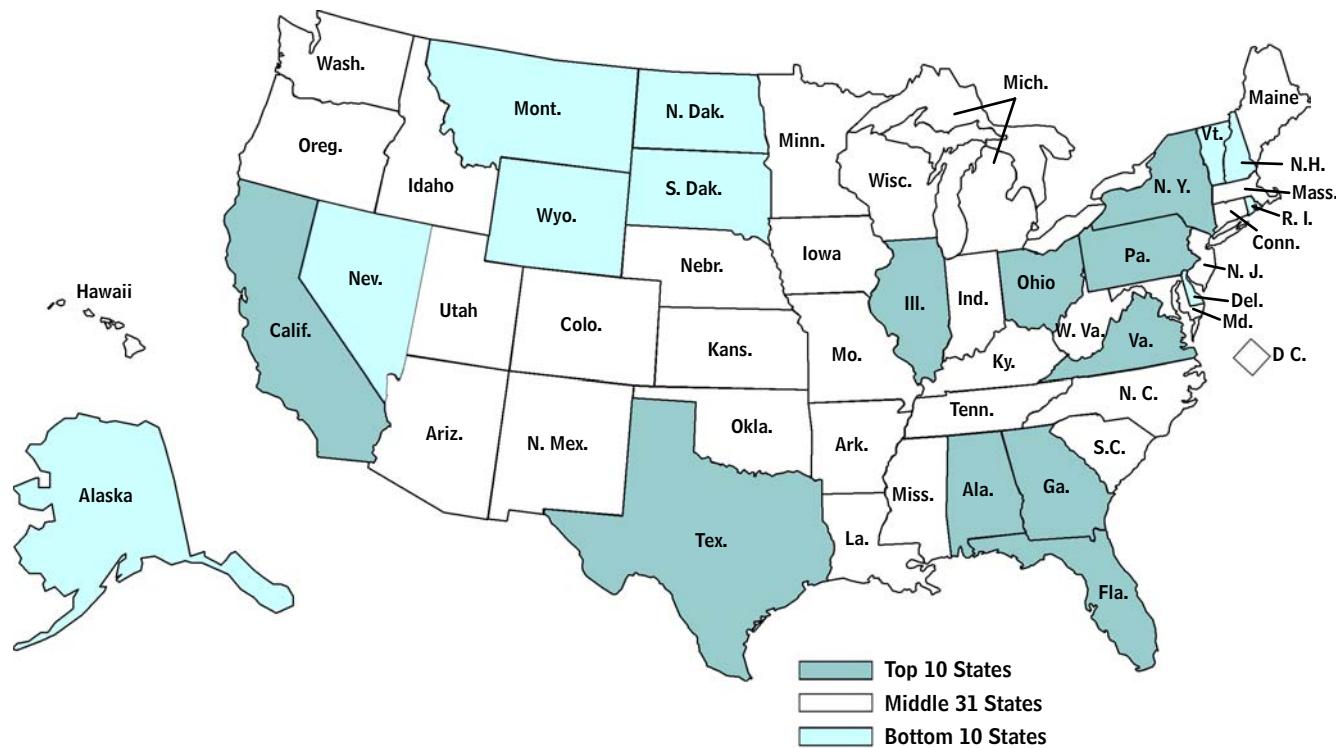
Reservists volunteer from all parts of the United States and its territories.⁵ However, more than 40 percent of the reserve population comes from 10 populous states: in descending order by number of reservists, they are Califor-

nia, Texas, Pennsylvania, Florida, New York, Ohio, Georgia, Virginia, Illinois, and Alabama (see Figure 2). The greatest concentrations of reservists as a proportion of population are in the District of Columbia, Hawaii, North Dakota, Vermont, Alaska, and South Dakota (see Figure 3). In those states, about 1 of every 100 residents over the age of 17 is a reservist.

Reservists also represent a wide variety of races and ethnicities.⁶ Although the bulk of the force (72 percent) describes itself as white, about 16 percent of reservists are black, and 9 percent are Hispanic, with other races and ethnicities making up the remainder. Seventeen percent of reservists are female.

5. Based on data on reservists’ states of origin from DoD’s Defense Manpower Data Center (for 2004) and from the Population Division of the Bureau of the Census (for 2003).

6. Based on data from DoD’s Defense Manpower Data Center as of September 2004.

Figure 2.**Selected Reservists by State, 2004**

Source: Congressional Budget Office based on data from the Department of Defense's Defense Manpower Data Center.

Note: Data include the District of Columbia as well as the Coast Guard Reserve.

Employment Profile

Among Selected Reservists in 2004, most (about 75 percent) worked for pay in the civilian labor force.⁷ Of that group, private-sector firms employed 52 percent (or about 335,000 individuals). Eighteen percent of paid reservists worked in firms with fewer than 100 employees (see Figure 4 on page 8); 8 percent worked in firms that

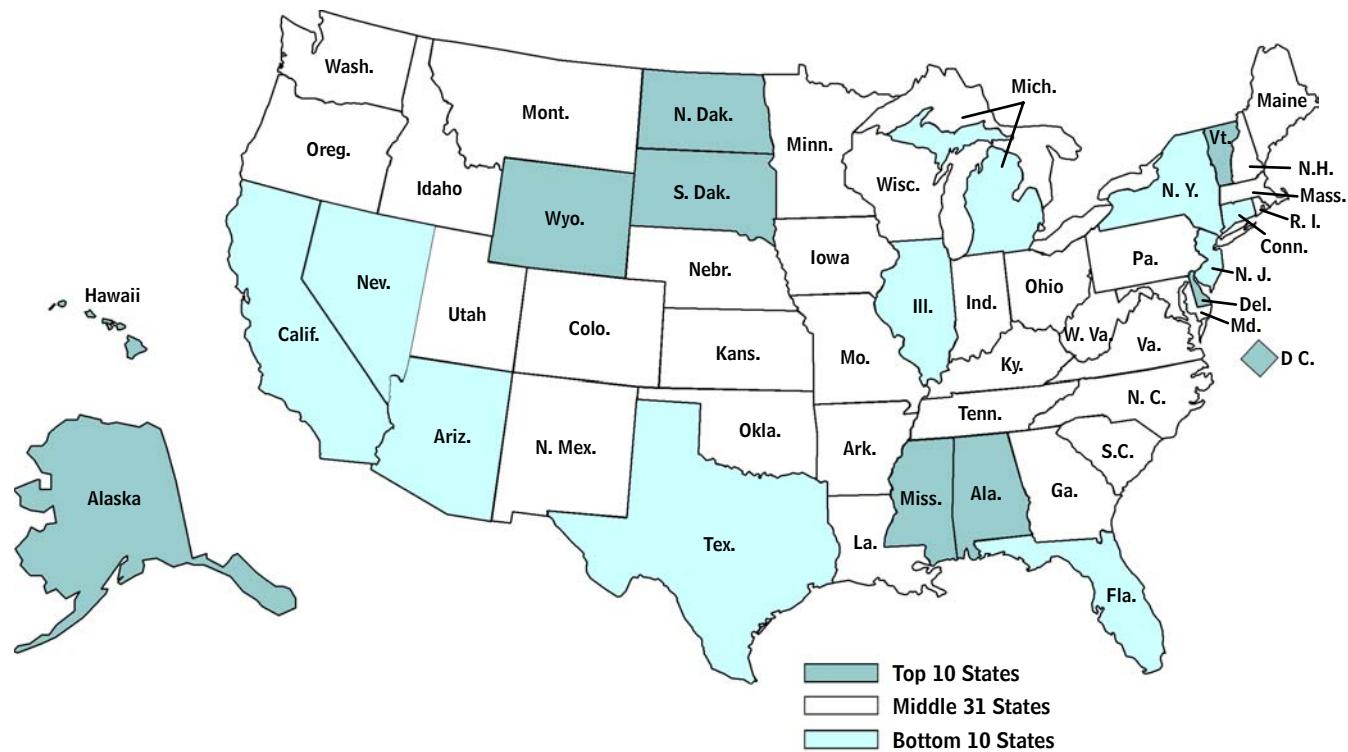
had between 100 and 499 employees; and another 26 percent worked in firms that employed 500 or more people. In addition, 9 percent (or 55,000) of Selected Reservists who worked in the civilian sector were self-employed or worked without pay in a family business as their primary source of employment. Four percent were employed by nonprofit organizations.

7. The data on reservists' employment derive from CBO's analysis of Department of Defense, Defense Manpower Data Center, *May 2004 Status of Forces Survey of Reserves* (CD-ROM release of data, February 2005). CBO's estimates include almost 70,000 military technicians who support the reserve units full time as government employees and are members of the Selected Reserve as a condition of employment. Estimates of reservists who work for pay in the civilian sector do not include Active Guard/Reservists, who make up about 9 percent of the Selected Reserve and are employed by the military.

Federal, state, or local governments employed 36 percent of Selected Reservists who worked in the civilian sector in 2004. Among those who worked for the federal government, DoD was the largest employer. The proportion of reservists employed in the public sector is larger than the proportion of nonreservists who work in that sector—a statement that holds true even after excluding the fairly sizable group of reservists who are full-time military technicians.

Figure 3.

Selected Reservists as a Proportion of a State's Population



Source: Congressional Budget Office based on data from the Department of Defense for 2004 and data covering 2000 to 2003 from the Population Division of the Bureau of the Census.

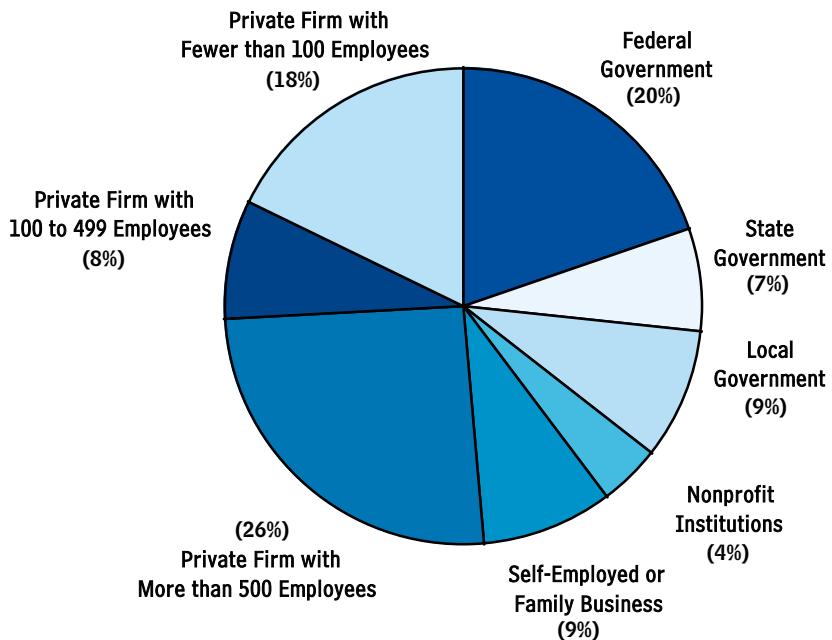
Note: Data include the District of Columbia as well as the Coast Guard Reserve.

Reservists differ from active-duty forces along several dimensions. With an average age of 33, reservists bring about five more years of experience to the military than active-duty service members do.⁸ In addition, reservists tend to be more highly educated. In 2000, about 17 percent of enlisted reservists had a bachelor's or higher degree compared with 9 percent of active-duty enlisted service members.⁹

Also differing somewhat from the active-duty force is the mix of occupations that the reserves represent. Some military capabilities, such as civil affairs and air traffic con-

trol, reside primarily in the reserve force. Generally, however, reservists are drawn from a variety of civilian occupations (see Figure 5). About 33 percent of reservists report that they are executives, managers, or professionals; of that group, managers or executives account for 24 percent, and health care practitioners and technicians make up 18 percent. The occupational category of executives, managers, and professionals is the largest among reservists (and is similar percentagewise to that category in the overall U.S. workforce).¹⁰ In general, the balance of the reserves (67 percent) is drawn roughly equally from service, sales, construction, and production occupations.¹¹

8. Data on reserve forces as of September 2004 come from DoD's Defense Manpower Data Center; data on active-duty forces are from Department of Defense, "2003 Demographics of the Military Community," available at www.mfrc-dodqol.org/stat.cfm.
9. For data on active-duty forces, see Congressional Budget Office, *Educational Attainment and Compensation of Enlisted Personnel* (February 2004). For data on reserve forces, see Paul Hogan, *2000 Survey of Reserve Component Personnel Overview* (Falls Church, Va.: Lewin Group, 2002).
10. Estimates of reserve forces are based on information as of 2000 obtained by CBO from DoD's Defense Manpower Data Center. Information on the U.S. workforce was drawn from Bureau of the Census, *Occupations: 2000*, Census 2000 Brief C2KBR-25 (August 2003), available at www.census.gov/population/www/cen2000/briefs.html.
11. Sales or office occupations have a much smaller representation among reservists than among the U.S. workforce—18 percent for reservists versus 26.7 percent of employed civilians.

Figure 4.**Civilian Employers of Selected Reservists, 2004**

Source: Congressional Budget Office based on data from the Department of Defense's Defense Manpower Data Center.

Notes: The data include the military technician category, personnel who support reserve units full time as government employees and are members of the Selected Reserve as a condition of their employment. The data do not include the Coast Guard Reserve.

Percentages may not add to 100 because of rounding.

The occupational profile of both self-employed reservists and reservists who are employed in small businesses tends to differ from that of the overall reserve force. Self-employed reservists are concentrated in fewer occupations than is characteristic of the reserves in total. They are most likely to consider themselves to be in construction and sales occupations; however, they are also more likely than reservists who are not self-employed to be health care or legal professionals or to work in occupations related to building and grounds maintenance. Reservists who work for small businesses are less likely than other reservists to be managers or professionals and more likely to be in occupations related to food service, construction, or sales.

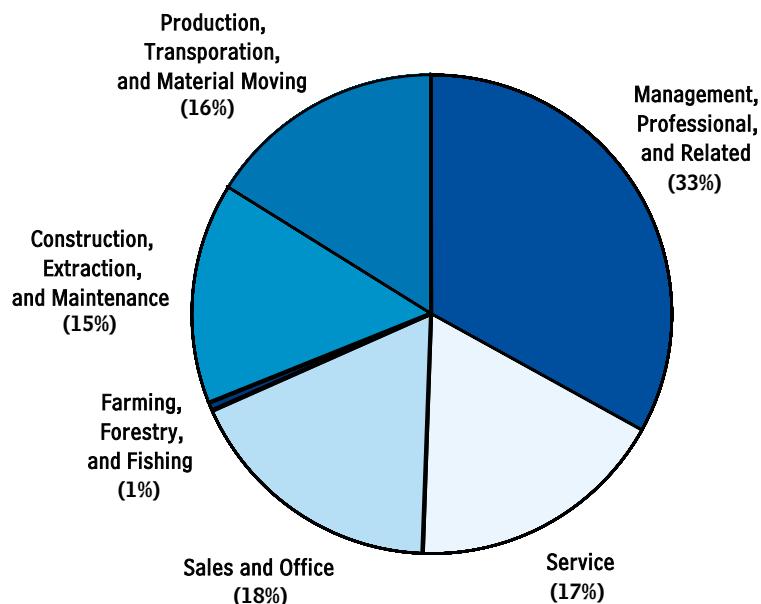
DoD's Use of the Reserves

In the early 1990s, while engaged in Operations Desert Storm and Desert Shield, DoD began mobilizing reservists more extensively than it had in earlier years, when reserve call-ups were rare. Since then, reservists have pro-

vided critical manpower for missions ranging from peacekeeping and humanitarian efforts to counterdrug operations and small-scale contingencies. After the terrorist attacks of September 11, 2001, however, the pace and extent of reserve call-ups increased, raising questions about the degree of the disruptions that both reservists and their employers are experiencing and the impact of those upheavals on the recruiting and retention of reservists. DoD plans to continue its reliance on reserve personnel for the foreseeable future, but at the same time it is considering several approaches for mitigating the potentially adverse effects of such a strategy.

Recent Mobilizations

Between September 2001 and November 2004, the Department of Defense called up more than 410,000 reservists. At the end of calendar year 2004, the number of reservists supporting DoD's current operations numbered 187,000.

Figure 5.**Civilian Occupations of Selected Reservists, 2000**

Source: Congressional Budget Office based on data from the Department of Defense's Defense Manpower Data Center.

Note: The data include the Coast Guard Reserve as well as the military technician category, personnel who support reserve units full time as government employees and are members of the Selected Reserve as a condition of their employment.

Increasing in tandem with those activations has been the time that reservists spend on active duty. Before Desert Storm/Desert Shield, the average number of days a reservist spent on active duty in exercises and operations each year was about one; that measure had risen to an average of more than 75 days in 2004 (see Figure 6). For reservists called to active duty since September 11, 2001, tours have averaged more than 300 days.¹²

DoD's activations of the reserves for its current operations have not been evenly distributed among the reserve components.¹³ The Army has supplied the bulk of the manpower: at the end of calendar year 2004, about 160,000 members (30 percent) of the Army National Guard and Reserve were on active duty in support of the

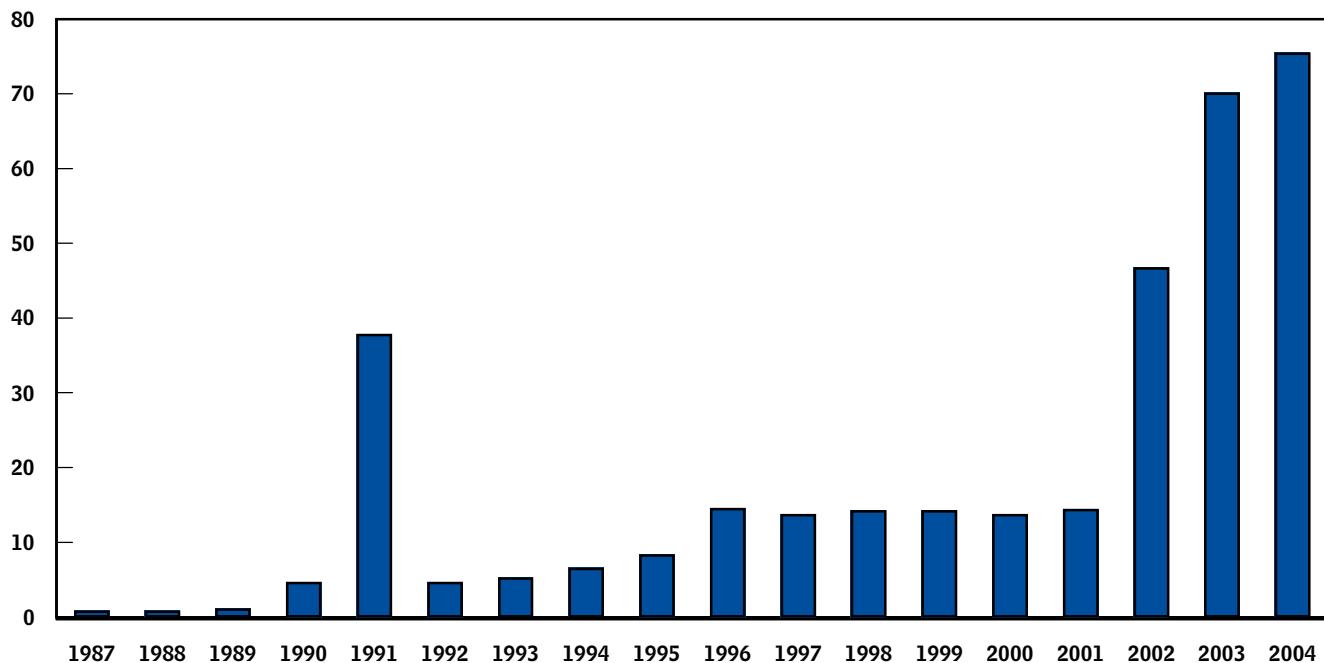
military's current operations. By comparison, the Navy had about 3,400 (4 percent) of its reservists mobilized.

In addition to differences in the mobilization rates of reserve components, the activation of reservists in particular occupations has varied, with some specialties being used much more intensively than others.¹⁴ For example, from September 11, 2001, through November 2004, call-up rates among some officer career fields (such as military police, intelligence, and fixed-wing aviation) had reached more than 45 percent. Mobilization rates for some enlisted specialties (such as installation security, law enforcement, and motor vehicle operators) were even higher, exceeding 55 percent. Some individuals—about 64,000 members (7.5 percent) of the Selected Reserve—had been mobilized multiple times. Yet reservists in other career fields (for example, medical and legal) experienced relatively low rates of mobilization.

12. Estimates are based on information as of November 2004 obtained by CBO from DoD's Office of the Assistant Secretary of Defense for Reserve Affairs.

13. Mobilization data are from the Department of Defense, available at www.defenselink.mil/releases/2004/dec2004.html.

14. Estimates are based on information as of November 2004 obtained by CBO from DoD's Office of the Assistant Secretary of Defense for Reserve Affairs.

Figure 6.**Annual Active-Duty Days per Ready Reserve Member**

Source: Congressional Budget Office based on data from the Office of the Assistant Secretary of Defense for Reserve Affairs.

Notes: Annual active-duty days include time spent mobilized to support the military services or combatant commands under voluntary and involuntary orders as well as to assist in domestic emergencies, counterdrug operations, and exercises. They exclude most training.

The number of days for 2004 is estimated.

Since the 2001 terrorist attacks, DoD has relied on involuntary mobilization, although some individuals have chosen to volunteer. Even before the attacks, some reservists volunteered for active duty, and some volunteered for longer-than-usual tours. In 2001, for instance, DoD activated more than 120,000 reservists for periods longer than 30 days; about 15 percent of those individuals served tours that exceeded 180 days.¹⁵ On the basis of interviews with reservists and manpower experts, CBO has concluded that those activations were largely voluntary. Some people signed up during slowdowns in their civilian jobs; others, because of their desire to serve. Those individuals, like reservists who are mobilized involuntarily, are also protected by the employment provisions of the Uniformed Services Employment and Reemployment Rights Act of 1994.

DoD's Plans for the Future

Military analysts anticipate that deployments of reserve personnel will remain an important component of fighting the global war on terrorism over the next few years. The Department of Defense expects that reservists' active-duty tours will continue at the current pace, lasting about one year, on average. However, to minimize the disruption to reservists' civilian lives, Secretary of Defense Donald Rumsfeld has directed the services to "limit involuntary mobilization to reasonable and sustainable rates, using not more than one year in every six as the planning metric."¹⁶

In addition, as directed by law, DoD conducts annual and contingency-specific screening of reservists to ensure their immediate availability for active duty.¹⁷ As part of

15. Estimates are based on information obtained by CBO from DoD's Defense Manpower Data Center.

16. Office of the Deputy Assistant Secretary of Defense for Reserve Affairs (Readiness, Training, and Mobilization), *Rebalancing Forces: Easing the Stress on the Guard and Reserve* (January 2004).

17. See 10 U.S.C. §12302, 10 U.S.C. §10149, 32 C.F.R. §§44.1-44.5, and Department of Defense Directive 1200.7.

Box 2.**The Continuum of Service**

The Department of Defense (DoD) has begun to implement a new management system that is designed to offer reservists more flexibility in fulfilling their reserve commitment. DoD officials envision a reserve force in which reservists can participate at varying levels of intensity at different points in their career—sometimes, for perhaps only a few days a year; at other times, for extended periods of as much as a year. To encourage alternatives to the traditional reserve commitment, the continuum would enable service members to move more easily between reserve status and active duty. DoD officials are currently studying how best to structure compensation to encourage such movement and are working to ease institutional policies that impede it. In addition, as part of the change, the Defense Department is seeking to develop new forms of affiliation among employers, potential reservists, and the military.

The result, some senior DoD officials believe, will be a more attractive form of military service that offers

new ways to serve. They are hopeful that with those changes, DoD can enlist people who were unable or unwilling to join previously—particularly individuals whom the military has had trouble recruiting and retaining in the past, such as people who have advanced technical skills. DoD officials believe that ultimately, the continuum will create a more flexible, capable reserve force.¹

1. For further discussion of the continuum of service, see Department of Defense, Office of the Assistant Secretary of Defense for Reserve Affairs, *Review of Reserve Component Contributions to National Defense* (December 2002); John D. Winkler and others, “A ‘Continuum of Service’ for the All-Volunteer Force,” in Barbara A. Bicksler, Curtis L. Gilroy, and John T. Warner, *All-Volunteer Force: Thirty Years of Service* (Dulles, Va.: Brassey’s, Inc. [now Potomac Books], December 2004); and Glenn Gotz, “Restructuring Reserve Compensation,” in Cindy Williams, ed., *Filling the Ranks: Transforming the U.S. Military Personnel System* (Cambridge, Mass.: MIT Press, 2004).

that screening, it assesses the hardship that individuals might face if they were mobilized. The annual program, which is suspended under partial or full mobilization, allows some Ready Reservists to transfer to the Standby or Retired Reserve or to be discharged. Those who may be eligible for transfer or discharge are reservists whose mobilization would:

- Result in extreme personal hardship or hardship for their community; or
- Seriously harm their employer’s ability “to perform functions essential” to the nation’s defense, health, or safety.

Currently, the annual screening program is suspended. However, since September 11, 2001, DoD has granted waivers or delays to about 225 reservists under a special exemption program.¹⁸

To help meet the military’s future needs for personnel, the Defense Department has begun to implement a new management system for the reserves. Called the “continuum of service,” it aims to provide a mechanism to allow individuals to serve in the reserves at varying levels of participation throughout their military careers (see Box 2).¹⁹ The continuum may encourage reservists to volunteer for active duty and may provide a greater range of opportunities for serving in the reserves. However, the military’s increased reliance on voluntary commitments may strain the operations of reservists’ civilian employers. Some

18. The annual screening program may be suspended at the discretion of the Secretary of Defense when an involuntary activation occurs under 10 U.S.C. §12304 (or a Presidential Selected Reserve Call-Up Authority). In September 2001, the program was suspended upon the authorization of partial mobilization, although DoD created a special exemption process in October 2001. In calendar year 2000, DoD removed 246 reservists from the Ready Reserve.
19. Because DoD is still refining and implementing the continuum concept, how the reserves will eventually be configured is uncertain, and the full implications for employers are unknown.

firms may find that their reservist employees are absent more often or for longer periods.

How Reservists' Call-Ups and Federal Protections Affect Employers

DoD's greater reliance on the reserves in recent years and its expectation of continuing that policy mean that private-sector employers of reservists and self-employed reservists may experience longer and more costly absences from the workplace. Legislated job protections—in particular, those contained in the Uniformed Services Employment and Reemployment Rights Act of 1994—hinder employers' ability to adjust to the mobilization of reservists and require that employers incur the cost of continuing some of those reservists' benefits while they are away. Thus, instead of DoD's bearing the full costs of a reserve mobilization, employers also bear some of the costs of call-ups.²⁰

Effects of Job Vacancies

The mobilization of reserve personnel can create involuntary and unexpected absences for employers. Businesses face decisions about replacing a reservist—whether to hire a substitute, have other employees fulfill the reservist's job duties, keep the position open and allow work to go undone, or, in the most extreme case, close the business.

No matter how a firm chooses to deal with the vacancy, the reservist's mobilization may disrupt the business's normal flow of work and entail costs. For example, hiring a new employee may require significant expenditures for recruiting, administration, and training. Although some recruiting and hiring techniques, such as direct application, can be inexpensive, others can be costly. Hiring through a temporary agency may increase employers' costs, even if the wages and productivity of the reservist and the temporary hire are comparable, because such agencies' fees generally exceed 50 percent of the temporary worker's wages. Also, fees charged by recruiting firms may range between 10 percent and 30 percent of a new

20. For additional discussions on employers' costs and ways to remunerate employers, see Glenn Gotz, *Strengthening Employer Support of the Guard and Reserve*, Document D-2755 (Alexandria, Va.: Institute for Defense Analyses, January 2003); and Colin M. Doyle and others, *Analysis of Employer Costs from Reserve Component Mobilization*, IDA Paper P-3872 (Alexandria, Va.: Institute for Defense Analyses, December 2004).

hire's salary in the first year. For a position paying the median national salary in the private sector (about \$40,000 in current dollars), firms could face direct recruiting expenditures of more than \$4,000.²¹ The time that staff members spend to screen and interview candidates adds to the costs of hiring.

Shifting personnel or allowing work to remain undone may also be costly. Shifting duties among a firm's remaining employees may require the business to pay overtime or suffer problems with employee morale and retention.

Some firms, regardless of how they deal with their reservist's absence, may find that they cannot continue business as usual. Work slowdowns or stoppages, an inability to deliver products, or a permanent loss in sales may be unavoidable. Some firms may even shut down when a reservist is activated or when they find later that they cannot operate for lengthy periods without their reservist employee.

Effects of Uncertainty About the Timing and Duration of Call-Ups

Employers often receive little warning of a reservist's mobilization. A survey published by DoD in 2003, which questioned reservists who had been mobilized over the previous 24 months, indicated that reservists notified their civilian employers an average of 13 days before their mobilization began.²² The survey also showed that almost 60 percent of reservists gave their employers advance notice of one week or less. A further problem for employers is that DoD sometimes changes reservists' mobilization or demobilization dates. In addition, for recent operations, DoD has extended many reservists' tours of duty during the time in which they were activated.

Lack of advance warning and uncertainty about reservists' activation or deactivation can exacerbate the problems that call-ups pose for employers. With little time to plan

21. See Bureau of Labor Statistics, *National Compensation Survey: Occupational Wages in the United States, July 2003—Supplementary Tables* (August 2004), Table 4.2. Annual earnings in 2003 dollars for white-collar workers in the private sector were \$45,962; for blue-collar workers, \$31,566; for service workers, \$19,239; and for professional specialty and technical occupations, \$56,927.

22. Department of Defense, Defense Manpower Data Center, *May 2003 Status of Forces Survey of Reserve Component Members: Tabulations of Responses*, DMDC Report No. 2003-10 (November 2003).

for a reservist's absence, firms may be less able to avoid vacancies. Some businesses that CBO interviewed for this analysis complained that they would not have filled an activation-induced vacancy as they had if they had known the reservist's actual dates of active duty. For example, one firm believed that its reservist employee—the network coordinator for its information technology operations—faced only a short mobilization. As a result, the firm contracted, at a premium, for a short-term worker to carry out day-to-day maintenance of its computer network. However, the reservist's tour was extended by more than six months, and the temporary hire proved significantly more costly than a permanent hire would have been.

Effects of USERRA on Employers' Labor Costs

The Uniformed Services Employment and Reemployment Rights Act of 1994 was enacted to minimize disruptions for people who serve in the uniformed services and to encourage military service by reducing any negative repercussions of individuals' service on their civilian careers. USERRA grants reservist employees broad job protections that apply to all employers (self-employed reservists are not covered by the law) and that protect full- and part-time workers as well as some temporary workers, regardless of the duration of their employment with the employer. The law applies to all personnel in the uniformed services (including the Commissioned Corps of the Public Health Service) and others whom the President may designate in time of war.²³

Broadly speaking, USERRA specifies the following:²⁴

- Employers may not discriminate against individuals in hiring, retention, promotion, or other aspects of employment on the basis of membership or service in a uniformed service.
- Employees absent from their civilian employment to serve in the uniformed services are entitled to reemployment and to the rights and benefits they would have had if they had been continuously employed, even if their service was voluntary. However, service members must meet certain criteria before USERRA's

23. USERRA's reemployment protections extend to national call-ups of the National Guard; they do not extend to state call-ups. Some states have state-mandated employment protections.

24. See Pub. L. 103-353, 108 Stat. 3150 (codified at 38 U.S.C. §§ 4301-4333), for the text of USERRA. The appendix provides additional discussion of some provisions.

reemployment protections apply. For one, USERRA's protections cease once a reservist's cumulative absences with an individual employer exceed five years. (Some duty, including annual active-duty training and involuntary call-ups as a result of a domestic emergency or war, is not counted toward the five-year limit.)²⁵

- Reservist employees continue to accrue pension benefits as they would have had if they had not been called up and may retain their health care coverage, although the reservist may be required to pay the full premium (including the employer's share).
- Employers must regard a reservist's absence for active duty as a leave of absence or furlough. Thus, employees who are reemployed under USERRA are entitled to all rights and benefits that other employees on non-military leave receive.²⁶

For several reasons, USERRA may increase the costs of hiring and retaining reservist employees. First, it limits employers' ability to adjust to reservists' absences. Second, it mandates that certain benefits that firms may pro-

25. Secretaries of the military departments individually determine whether voluntary duty after September 11, 2001, is exempt from the five-year limitation. To date, the Army has exempted voluntary duty when service in support of the war on terrorism exceeds 24 months. The other services have exempted all voluntary duty in support of the current partial mobilization of the reserves.

26. USERRA's reemployment rights and protections are somewhat similar to those provided under the Family and Medical Leave Act of 1993 (FMLA), which requires employers to grant unpaid, job-protected leave to employees who must be absent from work for specific medical reasons. Under FMLA, the employer must maintain the employee's group health care coverage, provided that the employee pays his or her share of the premium. In general, however, FMLA's provisions are less generous than USERRA's. For example, employers are not required to provide more than 12 weeks of leave in any 12-month period; employees must have been employed at the firm for at least one year to qualify for protected leave; and small businesses (those that regularly employ fewer than 50 employees) are exempt from the law.

USERRA's health care availability provisions for those ordered to active duty for more than 30 days are similar to the Consolidated Omnibus Budget Reconciliation Act (COBRA) health benefit provisions of 1986 (although COBRA does not apply to employers with fewer than 20 employees). COBRA permits certain former employees and others to buy into an employer-sponsored health insurance plan. Under both USERRA and COBRA, the employer may require the beneficiary to pay up to 102 percent of the cost of the insurance.

vide to activated reservists be continued. Third, it opens up employers to the risk—and the costs—of litigation.

Impact on Employers' Flexibility. When a reservist employee is mobilized, USERRA limits the actions that some employers might undertake to avoid the costs entailed by the vacancy. If the law were not in place, private-sector employers might shift the costs of reservists' absences to the employees themselves by lowering their wages when they were not activated or curtailing their benefits when they were. Alternatively, in the absence of USERRA, employers simply might not hire reservists.

USERRA's hiring and pay provisions, however, do not allow employers to pay reservists less than they would have received if they had not been in the reserves or to shift to less-expensive (that is, nonreservist) workers. Under the law, employers that have reservist employees must bear the extra costs of activations no matter the cause of the call-up—whether it be a national emergency or a reservist's preference for military duty. Because of that lack of flexibility, firms with reservist employees will have higher costs and lower profits than their competitors who have no reservist employees, all else being equal.²⁷ For short call-ups, the consequences for a firm's bottom line might be modest; for longer activations, the continued costs and lost revenues could be substantial.²⁸

Costs of Continuing Reservists' Benefits. USERRA's provisions explicitly address two common employee benefits: health insurance and pensions. The law specifies that an employee covered by an employer's health insurance plan may elect to continue coverage during his or her reserve service. For activations of 30 days or less, the employee may not be required to pay more than the employee's typical share of the cost; for service that exceeds 30 days, the employer may require the reservist to pay the premium—both the employee's and the employer's share—and some administrative fees.²⁹ CBO estimates that in 2004, U.S. employers' costs for health care coverage averaged about \$260 per month for single coverage and \$600 per month for family coverage.³⁰ If employers offer reservists the

27. A countervailing effect, however, might be that because of their military training, reservists are more productive than other employees with similar skills and education.

28. Whether call-ups affect economic growth in the long run is difficult to measure. Because in the past mobilizations have been relatively limited, there is not enough information available to conduct rigorous empirical studies.

minimum benefits required by law (some employers elect to offer more generous coverage), then the employers' costs for continuing their reservist employees' health benefits are likely to be similar to those estimated amounts, regardless of how long the call-up lasts.³¹

Employers that provide pension benefits to their employees must maintain a reservist's eligibility to participate in the firm's pension plan and must continue vesting and the accrual of benefits as if the employee were continuously employed. Employers offering defined-contribution retirement plans must match their reservist employees' contributions (at the rate established for the firm's plan) if the reservists pay into the fund.³² According to the Bureau of Labor Statistics, about two of every five private-sector workers contribute to a defined-contribution plan.³³ Although there is considerable variation, many employers match the first 6 percent of contributions at a rate of 50 percent.³⁴ By CBO's estimates, the cost to employers for reservists' benefits under such plans would av-

29. Under the Veterans Benefits Improvement Act of 2004, employers must provide that option for up to 24 months. Formerly, USERRA specified only 18 months.

30. In general, CBO's estimates of costs for health care benefits are based on Kaiser Family Foundation and Health Research and Educational Trust, *2004 Employer Health Benefits Survey* (Menlo Park, Calif.: Kaiser Family Foundation, 2004).

31. Reservists automatically have comprehensive health care coverage through the military health care system (TRICARE) when they are ordered to active duty for more than 30 days. Reservists' families are also eligible for TRICARE from the first day of the reservist's active-duty service if his or her orders exceed 30 days.

32. A defined-contribution plan specifies how much the employer will contribute annually and makes payments in retirement that depend on the investment return from those funds. A defined-benefit plan, by contrast, promises a specific benefit in retirement, and the employer is responsible for accumulating sufficient funds to pay it.

33. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2004* (November 2004). The data include both full- and part-time employees. As a context for the estimates, 59 percent of employers offer retirement plans, and 50 percent of employees who work for private employers participate in them—21 percent through defined-benefit plans and 42 percent through defined-contribution plans. Some employees participate in both types of plans.

34. Bureau of Labor Statistics, *Employee Benefits in Medium and Large Private Establishments, 1997*, Bulletin 2517 (September 1999), available at www.bls.gov/ncs/elas/home.html.

erage about \$175 per month, or \$2,100 for a one-year activation.³⁵

Under USERRA, employers that offer defined-benefit retirement plans must credit the time that the reservist spends in military service in computing benefits. About one of every five private-sector employees participates in a defined-benefit plan.³⁶ Typically, employers' expenses for reservists in defined-benefit programs—in CBO's estimation, about \$335 per month, or \$4,020 for a one-year activation—would be higher than their expenses for reservists in defined-contribution plans.

Some employers can bear additional costs without hardship, and evidence shows that many of them voluntarily offer reservists benefits that exceed those required by law. For example, almost 50 percent of private-sector employers offer some paid military leave to employees.³⁷ And according to recently activated reservists, about 16 percent of employers continued either full or partial pay for their employees' entire activation.³⁸ In addition, there is evidence that at least some firms continue to subsidize their reservist employees' health care insurance.³⁹ In a survey of large employers, 40 percent of respondents revealed that they maintained their reservists' health care coverage at existing levels for the duration of the activation. That action, however, may not be representative of all employers—or even of all large employers.

Potential Costs for Litigation Under USERRA. An employer may be required to remunerate a reservist employee for lost pay or benefits and litigation expenses as a result of its failure to comply with USERRA. If the employer is found to have willfully violated the law, the employee's award may be doubled.

35. CBO's estimates of the costs for private-sector employees' retirement benefits are based on Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry* and "Employer Costs for Employee Compensation—September 2004" (news release, December 2004).

36. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry*.

37. *Ibid.*

38. Department of Defense, Defense Manpower Data Center, *May 2004 Status of Forces Survey of Reserve Component Members: Tabulations of Responses*, Report No. 2004-015 (October 2004).

39. Mercer Human Resource Consulting, "Reservist Pay and Benefits—Results" (summary briefing, May 2003), available at www.imercer.com/us/qs/QuickStart.asp.

In 2004, reservists lodged almost 1,500 complaints with the Department of Labor against employers. A handful of cases was forwarded to the appropriate authorities for resolution. Among the remaining complaints, awards were made in about 500 instances; the average amount was roughly \$2,500.⁴⁰ (However, one recent case was settled for about \$500,000.) The \$2,500 average amount does not take into account other indirect or less tangible costs that employers may incur for such litigation—such as the time spent in resolving the case, fees for outside attorneys, higher premiums for liability insurance, and loss of goodwill among the community or employees.

CBO's Analysis of the Distribution of Businesses' Losses from Reservist Call-Ups

There is little direct evidence showing the extent of the losses experienced by firms that employ reservists. The Department of Defense has begun to systematically collect information about reservists' employment. It is also in the preliminary stages of surveying employers to gauge the extent of their support for reservist employees and the problems posed by those employees' activations.

Because that information is not yet available, CBO used existing survey data and interviews with reservists, military manpower experts, advocacy groups, and others to shed light on how calling up reservist employees might affect different types of employers.

Data from Interviews

CBO conducted 19 interviews with a cross-section of reservist business owners and employers who had reservists in their workforce. Those interviews included 12 recipients of Military Reservist Economic Injury Disaster Loans (MREIDLs) from the Small Business Administra-

40. The National Committee for Employer Support of the Guard and Reserve, a DoD organization that provides information on USERRA to employers and reservists and informally mediates complaints, reported more than 5,600 inquiries in calendar year 2004 that required the services of an informal ombudsman. Underreporting of violations is possible, for several reasons. Some reservists may not know their rights under USERRA, or employers may violate the law but cite other reasons for an adverse employment action. As a result, the actual cause for the employer's action may be difficult to discern.

tion.⁴¹ In addition, through the newsletter of the National Veterans Business Development Corporation, CBO solicited accounts of businesses' experiences. (The Veterans Corporation, a nonprofit organization created in 1999 under Public Law 106-50, assists veteran-owned businesses.) CBO also contacted three Fortune 500 companies.

CBO obtained information on 28 separate mobilizations (some firms had multiple reservists who were mobilized or an individual who had been activated more than once). Mobilizations of reservist business owners accounted for the majority (15) of the call-ups. Another six of the mobilizations were reservists employed at firms with fewer than 50 employees; the remainder were employees of Fortune 500 companies. One-half of the mobilizations lasted for more than eight months.

CBO's findings based on those limited data should be interpreted with caution. In particular, the experiences of these firms should not be attributed to the entire population of reservist employers and business owners, nor even to other businesses of the same or a similar size. For example, recipients of MREIDLs are probably among those small businesses that face relatively large losses. To qualify for such loans, a small business that experiences the call-up of a critical employee must be able to demonstrate that financial injury resulted from the mobilization. Also, the three large employers that CBO interviewed offer benefits that exceed those that the law requires. As a result, they may support and accommodate the needs of their reservists to a greater degree than other employers do.

Nevertheless, although the experiences of the businesses that CBO interviewed may not be typical of reservist employers as a whole, the analysis can shed some light on the effects of call-ups since it included diverse industries, geographic locations, and reservist occupations. The employers ranged from large telecommunications firms to small manufacturers and retail stores. The occupations of the called-up reservists also varied, from managers, physicians, and information technology personnel to sales personnel, service technicians, and shipping clerks.

41. The MREIDL program, which was established by the Veterans Entrepreneurship and Small Business Development Act of 1999 (Public Law 106-50), is discussed later.

In its interviews, CBO asked about the reservist's skills, the duration of the call-up, how the company handled it, and its financial impact. The stories of individual firms, some of which are included in the following discussion, illustrate how businesses respond to the mobilization of a reservist and the kind of losses that some employers face.

Findings

Most firms are not affected by reservists' activations simply because they do not employ reservists. Six percent of business establishments employ them;⁴² less than 0.5 percent of self-employed individuals are reservists.⁴³ The limited information available indicates that among businesses with reservist employees, those that require workers with highly specialized skills and those small businesses that lose key employees when reservists are called up are likely to experience the greatest impact. Also probably affected to a larger extent are self-employed reservists.

There are no precise data on the number of reservists who are key employees or who have highly specialized skills. However, on the basis of information about reservists' civilian occupations, CBO estimates that the number of drilling reservists who work in highly skilled or key positions in small businesses is probably between 8,000 and 30,000.⁴⁴ With more than 410,000 drilling reservists mobilized since the September 11 terrorist attacks, as many as 15,000 small businesses, in CBO's estimation, may have experienced financial losses or had significant problems managing their workloads or scheduling, or handling other interruptions to their operations. Of the reservists called up, about 26,000 of them were probably self-employed. With almost 5 million small businesses and another 15 million self-employed people in the United States, the number of affected businesses has been

42. Veronia Nieva and others, *1999 Employer Reservist Survey: Final Report* (Rockville, Md.: Westat, Inc., August 2000).

43. Estimate based on CBO's analysis of Department of Defense, *May 2004 Status of Forces Survey of Reserves*; and Bureau of Labor Statistics, "Self-Employment in the United States: An Update," *Monthly Labor Review* (July 2004), pp. 13-23.

44. The lower bound equals CBO's estimate of reservists employed as executives or managers in small businesses, whereas the upper bound equals CBO's estimate of reservists who are executives, managers, or professionals in small businesses. Those estimates are based on information as of 2000 obtained by CBO from DoD's Defense Manpower Data Center and Department of Defense, *May 2004 Status of Forces Survey of Reserves*.

comparatively small.⁴⁵ However, the problems that individual firms face when reservist employees are mobilized can vary substantially.

Additional findings by CBO based on the businesses it interviewed include the following:

- The call-ups of reservist employees were disruptive regardless of a firm's size. However, the large businesses that CBO interviewed did not experience any significant losses, whereas the small businesses, even those that did not receive a MREIDL, commonly experienced declining profits.
- Many of the small businesses and medical or dental practices did not hire a replacement for their critical reservist employee. Some of those that did experienced lower revenues or problems in managing production.
- Several of the smallest businesses that lost critical employees either fully or partially shut down for the duration of the mobilization.
- Although some firms received more than a month's advance warning of the call-up, several received less than three days' notice and were more likely than firms that received more warning to have difficulty adjusting to the vacancy. (For example, one business owner hired a replacement for himself sight unseen.)
- Many of the businesses responded that they did not have a plan in the event that their reservist employee was activated, although they knew a call-up was possible.

Effects on Firms with Highly Specialized and Skilled Workforces

Workforces. It is likely that USERRA disproportionately imposes greater costs—resulting from both mandated benefits and the reservist's absence—on employers who use a more specialized or skilled labor force. For example, retirement benefits are generally based on an employee's wages. Since highly skilled or specialized employees are usually paid more than those with lesser skills, employers'

45. In 2003, according to the Bureau of Labor Statistics' Current Population Survey, a little more than 10 million self-employed individuals were unincorporated; another 5 million were incorporated. The number of small businesses (those with fewer than 100 employees) comes from the Census Bureau's *Statistics of U.S. Businesses* for 2001 and is available at www.census.gov/epcd/www/smallbus.html#empsize.

costs for retirement benefits will also be higher when such employees are mobilized. In addition, skilled employees are much more likely than their less skilled counterparts to participate in retirement plans (53 percent versus 18 percent, respectively, for defined-contribution plans).⁴⁶ CBO estimates that the average annual cost of providing pension benefits (whether under a defined-contribution or defined-benefit plan) for a professional worker who participates in an employer-sponsored program is about \$5,300; for a service worker, the cost is \$1,700.

The cost of the vacancy created by a highly skilled reservist who has been called up is also likely to be greater than that for a less skilled individual. For example, finding and hiring a replacement will probably be more expensive. For many jobs that require relatively few specialized skills, inexpensive recruiting methods such as direct application or personal referrals can generate a relatively large pool of applicants. By contrast, employers with vacancies that demand highly specialized or specially certified personnel typically incur higher costs in generating an applicant pool because they may rely on advertising in newspapers and professional journals or perhaps even use specialized job placement firms. For a job offering a salary of \$100,000, the direct costs of recruiting, screening, and hiring may exceed \$15,000. Significant expenditures of time potentially add to that cost.

An additional complication arises when reservists who have skills and knowledge that are particular to their employer are activated. In that case, a replacement might require extensive training and not be fully productive for some time. The employer would then bear the costs of both the training and the new employee's lower productivity.

CBO's interviews with firms that had reservist employees indicated that employers may not replace highly skilled personnel but may instead shift the firm's workload among their remaining employees, scale down production, or allow work to go undone. The time and expense of recruiting combined with the lower productivity of replacement workers make it likely that an employer will not replace the reservist employee unless the firm has no one else on its payroll with similar skills. All else being

46. Skilled employees here are defined as white-collar workers; less skilled workers are those employed in service occupations. See Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry*.

equal, the financial losses of firms that employ highly skilled reservists will probably be higher than those of other employers that face reserve call-ups.

Although CBO's findings from its interviews should not be generalized to all businesses, they do illustrate what some individual businesses are facing when they lose reservist employees to a call-up. One small firm that CBO surveyed had experienced two separate call-ups among its workforce of about 30: the manager of operations and sales (for a nine-month activation) and the shipping/receiving clerk (for a one-year activation). The firm hired a replacement for the clerk before the reservist employee was deployed, and although the replacement took a couple of weeks to gain proficiency, the firm's sales and profitability did not drop. In fact, because the hiring and recruiting costs for the position were low and the individual was not very experienced, the firm believed that the total costs for the replacement were lower than the reservist's normal compensation.

By comparison, the manager's call-up had more-severe repercussions. Unable to find an outside replacement who knew the specialized production processes and the customer base, the company instead relied on existing staff to cover the job functions as best they could. But the remainder of the staff did not have the manager's sales and operations management expertise, and consequently, service to existing clients suffered and no new sales were generated. Indeed, the firm maintained that its sales fell by about 40 percent during the call-up period, and its profits were eliminated. Although the firm did not lay off any staff, it required long-term loans to cover its operating expenses.

Effects on Small Versus Large Firms. The provisions of USERRA that require employers to continue activated reservists' benefit coverage disproportionately affect large employers. Employees of larger firms are almost twice as likely as their counterparts at small businesses (67 percent versus 37 percent) to participate in retirement plans; they are also more likely to participate in defined-benefit plans (which are more costly for employers, on average).⁴⁷ Consequently, larger employers are more likely to face additional retirement costs when reservists are called up—by CBO's estimates, an average of \$330 per month com-

47. See Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry*. In this case, large employers are those with 100 or more employees.

pared with \$220 per month for small firms. Large employers typically also pay more for USERRA-mandated health care coverage: about \$640 per month for family coverage compared with smaller firms' costs of \$520 per month, on average.⁴⁸ In addition, more employees at large firms than at small businesses (68 percent versus 50 percent) are covered by employer-sponsored health insurance. Among those covered employees, more large-firm employees (41 percent) elect family coverage than do small-firm employees (33 percent).

The cost of the vacancy, however, will probably be higher among small businesses, which are unlikely to have more than one individual with similar skills and thus cannot as easily shift the reservist's workload to other employees. The small businesses that CBO interviewed indicated that such shifting, particularly for positions held by highly skilled reservists, was often not feasible. In addition, some data suggest that smaller firms are at a relative disadvantage in several respects when their reservist employees are activated, consistently experiencing more problems than their larger counterparts do with such activities as finding and hiring replacement workers, scheduling work, and delivering products.⁴⁹ Since the ability of small firms to shift their workload is more limited, they are more likely to leave the position vacant or hire a temporary employee. If it costs less to shift work than to hire additional labor or leave a position vacant—a likely scenario—small firms will experience greater financial losses than larger firms when their reservist employees are called up.

CBO interviewed both large and small employers, and their anecdotal accounts of the effects of reservist mobilizations illustrate the differences discussed above. At one Fortune 500 company, one of the firm's network engineers had been mobilized twice since the 2001 terrorist attacks. The first call-up lasted six months; the second was ongoing at the time of CBO's interview. The reservist was part of a group of 10 network engineers. For both ac-

48. CBO's estimates based on Kaiser Family Foundation and Health Research and Educational Trust, *2004 Employer Health Benefits Survey*. That survey classified employers with fewer than 200 employees as small and those with 200 or more employees as large.

49. Nieve and others, *1999 Employer Reservist Survey*. In that survey, companies with fewer than 50 employees were classified as small employers, whereas firms with 50 or more employees were classified as large employers.

tivations, the company hired a contract worker as a replacement (at a higher wage than the reservist received). Because the replacement did not know the work environment well, the firm redistributed the more complicated and long-term tasks to the permanent staff. Although the firm considered the replacement's productivity to be lower than the reservist employee's productivity, the impact of the call-up on the company was negligible.

By contrast, the service manager of one small business that sells and repairs office machines has been mobilized intermittently since September 2001, and the company hired an additional permanent worker to carry out his duties. Because the position required multiple certifications, the recruiting and hiring process was a time-consuming one, according to the firm, and the replacement did not begin work until about two months after the job search began. Adding to the burden on the firm was that the replacement required classroom and on-the-job training; in addition, his productivity through his first year was lower than the reservist's (although the costs he generated, including the expenditures for training, were higher). The firm claimed that it was unable to fulfill some contracts and that its profits declined significantly. To mitigate some of the problems it was having in meeting its operating costs, the firm obtained a long-term loan.

Effects on Self-Employed Reservists. Typically, reservists who are self-employed are essential to their own business, in part because they generally possess special skills or knowledge. As such, the absence of the reservist owner can have a significant impact on the firm's health. Thus, on the one hand, reservist-owned businesses are among the most likely to be harmed by involuntary call-ups. On the other hand, voluntary call-ups may benefit self-employed reservists. If timed to occur during seasonal or economic slowdowns, voluntary call-ups can smooth seasonal fluctuations in the owner's income.

Two pieces of legislation enacted in recent years are relevant to self-employed reservists. The Veterans Entrepreneurship and Small Business Development Act of 1999 provides financial and other assistance to small businesses that are hurt when an "essential" employee or owner is ordered to active duty in support of a military conflict.⁵⁰ For preexisting direct loans by the Small Business Administration (SBA), the law requires the SBA to defer repayment of the principal and interest and to reduce the loans' interest rates; the law also requires the SBA to en-

courage lenders that are participating in SBA loan programs to defer repayments.⁵¹ For businesses that meet certain criteria, the SBA is also authorized to provide working-capital loans—Military Reservist Economic Injury Disaster Loans—at interest rates that are lower than those prevailing in the market. A further feature of the law is that it makes SBA programs for business counseling and training available to any small business that is adversely affected by a reservist's mobilization.

The other law that helps some self-employed reservists is the Servicemembers Civil Relief Act of 2003, which provides active-duty personnel and reservists with relief from a myriad of financial and civil obligations. In particular, it allows certain self-employed reservists to:

- Suspend and reinstate professional liability insurance;
- Reduce certain business debt interest costs; and
- Terminate certain business lease agreements arising before the reservist's active-duty service.

Reservist business owners report that their firms face substantial hardships when call-ups occur. According to one DoD survey, 33 percent of self-employed reservists who had not been activated in the past two years responded that a three-month mobilization or deployment would pose a very serious or serious problem to their business or professional practice; 22 percent of reservists who had recently been activated said that the damage actually done to their business was a serious or very serious problem.⁵² That statement appears to be borne out by the fact that more than 50 percent of the businesses to which the SBA awarded MREIDLs were owned by the reservist who had been called up.

CBO's interviews with recently demobilized reservists confirmed that the impact can be severe. Although some

50. The law (Pub. L. 106-50, 113 Stat. 233) defines an essential employee as someone "employed by a small business concern and whose managerial or technical expertise is critical to the successful day-to-day operations of that small business concern."

51. The period of assistance on existing loans may begin upon the receipt of orders and ends no later than 180 days after the reservist is released from active duty. Deferrals and interest rate reductions are not automatic.

52. Department of Defense, *May 2003 Status of Forces Survey of Reserve Component Members*.

reservist owners subcontracted with competitors to fulfill existing contracts and some found other reservists to fill in for them, some owners reported that they had had to lay off part or all of their staff, and several had to close their businesses for the duration of their activation. Those who closed earned no profits. Some self-employed reservists reported that they had greater indebtedness at demobilization than before they were activated because of ongoing business-related expenses (such as payments for rent and equipment).

The self-employed reservists that CBO interviewed also indicated that the effects on their businesses extended beyond the time of their activation and that it often took several months after their businesses or practices were fully operational for their sales and receipts to return to predeployment levels.

The circumstances of a dentist that CBO interviewed offer some insight into what reservist owners face. The dentist, who had a small staff, was called up early in 2003 for three months; including training, he was away from his practice for about four months. Because his most recent activation did not entail deploying overseas, he was able to return home occasionally to maintain his practice. Revenue, however, dropped by about 90 percent. He laid off one employee and reduced the hours of the others. Because of recurring monthly expenses and lost revenues, he calculated that the activation cost him between \$200,000 and \$250,000 in a practice that typically generated annual revenues of double those amounts. He applied for a MREIDL but did not qualify. Instead, he added personal debt and refinanced an existing business loan. Despite learning that he would probably deploy again in 2005, he has no plans to quit the reserves.

Options for Alleviating Businesses' Costs for Reservist Activations

Although the mobilization of reserve personnel leaves most employers unaffected, a small number of firms have experienced a severe impact from reservists' activations. That circumstance has led to interest in ways to alleviate the difficulties that employers confront.⁵³ Proponents argue that there are several reasons to help employers of reservists and reservist owners of businesses—for example,

53. States have carried out several initiatives, but most focus on alleviating the effects on reservists rather than the costs confronting employers. For a brief discussion, see Box 3.

to help reduce, if not entirely eliminate, the competitive disadvantage that those businesses face and to ease DoD's recruiting and retention efforts by encouraging firms to be more supportive of reservist employees. Proponents also contend that employers are being unfairly asked to bear the costs of reservists' mobilization.

One argument of proponents has been that special consideration is justified at least for certain classes of employers that bear a disproportionate share of those costs. One such class might be self-employed reservists. Observers who support special consideration for them would probably acknowledge that self-employed people freely chose to join the reserves after weighing the impact that call-ups would have on their business—but they would also note that the frequency and duration of recent mobilizations have been unprecedented and exceed the expectations that self-employed reservists had when they volunteered. Indeed, self-employed reservists may have made choices (such as not developing a complete backup plan for their own activation) that initially seemed reasonable but that have proven inadequate under actual circumstances. By that argument, they might merit some compensation.

Other people would argue that no remediation was necessary for any group of business owners, claiming that employers ought to sacrifice for the greater public good. They would note that some employers offer their reservist employees more benefits than are required by law (presumably either from a sense of patriotic duty; to capture the goodwill of their customers, workers, and community; or to attract reservist applicants for jobs). Paying compensation to those employers would reward them for something that they were doing anyway and from which they might already be benefiting.

Effects on Stakeholders

In its analysis of potential options for mitigating the problems that some private employers might be experiencing from call-ups, CBO considered the alternatives' effects on three categories of stakeholders: DoD, reservists' employers, and reservist employees.

The Department of Defense. DoD pursues a personnel policy that calls for a mix of active-duty (permanent) and reserve (temporary) forces. The reserves provide a "surge" capability for the military, and they cost DoD relatively little when they are not activated—compared with DoD's costs for active-duty service members. Although the reserves are used continually, they are activated in much

Box 3.**State Initiatives**

Many states have acted to assist their reservists, but in general, employers have received little aid at the state level. A range of assistance may be provided to reservists who have been mobilized, including the following:¹

- *Financial relief.* More than two-thirds of states provide relief for certain reservists from property or income taxes or extend tax-filing deadlines. In addition, some states have set up funds to supplement some reservists' military pay. Further, more than half of the states give reservists who are state employees some military leave with pay. Some of those states make up the difference between what the military pays and the employee's regular salary. Still others grant full or partial pay, usually with some limits on its duration.
- *Education assistance.* Most states offer some assistance ranging from tuition refunds for reservists who are called up to scholarships for family members.

1. See also the National Governors Association publication "State and Territorial Support for National Guard and Regular Military Members and Their Families" (October 2004).

- *Employment assistance.* States generally offer protection of reservists' employment in a manner similar to that provided under USERRA but covering states' activation of their National Guards. In some states, preference is given to veterans in decisions about hiring for state government jobs.
- *Other benefits.* These range from providing mobilization guides to reservists and their families to paying for life insurance.

By contrast, the assistance that states offer to reservists' employers or reservist business owners appears to be very limited. Self-employed reservists are more likely than reservists' employers to receive assistance—because as reservists, they may receive special reductions in personal property taxes or state income taxes. A small number of self-employed (incorporated) reservists may also receive unemployment insurance compensation when their tour of duty is finished. A few states extend or waive deadlines for professional licensing or have or are considering legislation to grant state income tax credits to employers of reservists.

greater numbers during wartime or national emergencies. To meet its manpower needs, DoD must offer compensation or conditions of service that are attractive enough to induce a sufficient number of individuals to join and remain in the reserves. USERRA is one part of the incentive package offered to potential reservists. DoD, however, does not pay the costs associated with the law's benefits; as a result, civilian employers bear a portion of the expenditures that call-ups generate.

DoD weighs costs and benefits in deciding when to rely on its military reserves. However, the Defense Department may overutilize the reserves relative to active-duty forces because the costs of using reserve personnel appear to be lower than they actually are. Policies that shifted the

costs of call-ups from employers to DoD might lead the Defense Department to improve its allocation of personnel within the military and between the military and the private sector.

Employers. Employers also weigh the benefits of hiring and retaining reservists against the costs they entail and against the costs and benefits of hiring nonreservists. The presence of USERRA increases businesses' costs. Policies that decreased employers' costs from mobilizations would reduce or eliminate the difference in costs between employing reservists and employing nonreservists. In that case, employers should have little or no incentive to choose nonreservists over reservists, all else being equal, and employers' support for reservists might increase.

Reservist Employees. Also to be considered is that reservists (including the self-employed) voluntarily decide to join and stay in the reserves on the basis of the value they receive from reserve service compared with the costs they incur from it. The value they derive includes compensation and nonpecuniary rewards, such as the satisfaction of serving their country. The costs might include the risk of injury or death and any negative repercussions of their service on their civilian career.

Without USERRA's protections, reservists might receive lower compensation relative to the compensation of non-reservists, or they might not be hired for a job. As a result, they would seek positions with firms that could most easily absorb the costs of call-ups. USERRA lessens some of the costs of serving in the military and makes that service more attractive. Policies that increased the willingness of employers to hire and retain reservists would also probably lower the costs of military service for those employees and could increase participation in the reserves.

Potential Alternatives

CBO evaluated the effects of several potential measures to help employers deal with the problems that call-ups may pose. The measures include compensating businesses through tax credits or direct payments, subsidizing loans to employers, providing or subsidizing call-up insurance for businesses, and exempting certain reservists from call-ups.

Compensate Businesses Through Tax Credits or Direct Payments.

Providing remuneration for disruptions or losses would reduce or eliminate the hardships that some firms undergo when their reservist employee or owner is mobilized. Compensation could be based on one of the following:

- Lost profits;
- The costs of continuing legally mandated benefits for activated reservists;
- Replacement costs (for recruiting and hiring a new worker); or
- Other (nonpecuniary) problems, such as difficulties for employers in scheduling work or uncertainty about a reservist's mobilization and demobilization.

Possible Mechanisms. Several different approaches might be used to compensate employers of reservists or reservist business owners. One way would be for the federal government to reimburse a firm's lost profits. Changes in a firm's profitability reflect changes in its revenues or costs. To fully compensate employers, remuneration should equal the decrease in a firm's profits that resulted from a call-up. The use of that kind of mechanism would eliminate losses stemming from the costs of replacing a reservist or continuing his or her benefits, or from lower receipts. However, it is virtually impossible to measure lost profitability. A business's receipts and profits fluctuate for many reasons, including changes in the economy or in tax law, the number and behavior of its competitors, and other factors. Generally, the impact of any one employee's absence is difficult to discern.

It would be easier for both the government and employers to use measures other than profits to approximate a firm's financial loss. The simplest method would be an award based on a fixed reimbursement rate. Employers could be paid a set amount for each reservist who was activated or for each month that the reservist was mobilized. As more-detailed information on employers' costs for mobilized reservist employees became available, the levels of the awards could be based on a firm's industry, size, or geographic location or the reservist's occupation or position. That approach would allow the fixed remuneration to more closely correspond to the likely loss that the reservist's employer or business experienced.

Yet the financial injury that employers sustain probably varies even among firms in the same industrial category. With a fixed reimbursement rate, the payment would not be directly linked to the loss that an individual employer had to bear. Some employers would be overcompensated and others, undercompensated.

Another alternative would be to compensate firms for readily identifiable expenditures, such as the costs of recruiting replacements or providing legally mandated benefits. The advantage of that approach is that although unlikely to offset a firm's total losses, it might more closely approximate them for some employers than a fixed reimbursement would. The method has several drawbacks, however. First, accounting for and verifying costs could be relatively more difficult than under some other ap-

proaches.⁵⁴ Second, the federal government might end up reimbursing companies for benefits they would have offered even without USERRA's mandates and consequently would pay some firms more than they required to offset the difficulties they encountered. Third, the reimbursement could alter employers' responses to a call-up, encouraging activities that were eligible for reimbursement but not necessarily economically efficient. Finally, some firms that were harmed by call-ups would receive no financial assistance. Examples are businesses that had no readily identifiable costs (such as those that relied on shifting work or allowing it to remain undone during the reservist's activation) and firms that shut down.

Policymakers could also choose to reimburse employers on the basis of a reservist's civilian compensation, which is a measure of productivity and thus represents the employee's value to the firm.⁵⁵ One advantage of such an approach is that it should be relatively easy to administer. In addition, it would aid all firms that had reservist employees who were mobilized—regardless of how the firm dealt with the vacancy. At the same time, however, it might overcompensate some employers—most probably, firms that could shift or hire personnel easily. Moreover, if such a provision applied to self-employed individuals, it would provide an incentive for those with high earnings to join the reserves—which would result in DoD's substituting more-costly reservists for less-costly ones. To diminish that possibility, payments could be capped.

A further issue would be whether to reimburse employers through direct payments from the federal government or through the tax code. If a mechanism could be developed so that DoD bore the cost of payments to employers (and thus more of the costs of call-ups), one advantage of making those payments direct reimbursements would be that DoD would be better able to evaluate the most cost-efficient mix of reserve and active-duty personnel. Also, as DoD found that the costs of reservists varied on the basis of their civilian employment, it would have an in-

centive to recruit civilians from lower-cost sectors of the business community. Consequently, the value of the labor resources that were diverted from the civilian economy might decline. One drawback of direct payments, however, is that DoD would need to create a new unit, or work with other federal agencies, to administer the program.

By contrast, tax credits, though not without their own difficulties, could be administered through the existing tax system. (Such difficulties might include noncompliance—employers' claiming a credit when they do not qualify for one—and enforcement.) A disadvantage of tax credits is that they would not aid firms that had little or no business income or that were tax-exempt nonprofit entities.

No matter how the government chose to remunerate employers with activated reservists, some firms would see their costs fall. The competitive disadvantage faced by employers of reservists would be reduced, if not entirely eliminated. As a result, businesses would be more likely to support their reservist employees' service, and the reservists' civilian work environment might improve. In turn, people might be more likely to join or remain in the reserves.

Proposed Legislation. Legislation to compensate self-employed reservists or reservist employers affected by call-ups was introduced in the 108th Congress. However, either the bills were not enacted, or the portions relating to compensation were removed from larger bills prior to their passage. The relevant provisions of some of those bills are briefly described below.

■ *Jumpstart Our Business Strength (JOBS) Act, S. 1637.* This Senate bill included an income tax credit for costs incurred by an employer to replace reservists who had to be absent because of active duty. Available to small businesses, the credit would have been based on the replacement's compensation and capped at \$6,000 per year for most employees (\$10,000 for employees in certain manufacturing sectors). The bill also included a tax credit for employers based on the amount that employers paid in total compensation to their reservists who were absent for active-duty service. That additional credit was limited to \$15,000 per year or less for most reservists. The Joint Committee on Taxation estimated that for 2005, the cost of those provisions would have been \$320 million. Both tax credits

54. The experience of the British is instructive. Since the late 1990s, employers can provide documentation and receive some reimbursement to help cover recruiting, overtime, and other costs associated with reservist employee call-ups. However, the requests have been relatively fewer than anticipated. Surveys and anecdotes point to burdensome documentation requirements and low reimbursement rates as reasons.

55. Because total compensation is difficult to calculate, the reimbursement might be based on cash compensation.

were removed from the final bill. (The final bill, H.R. 4520, was enacted as Public Law 108-357 in October 2004.)

- *National Defense Authorization Act for Fiscal Year 2005, H.R. 4200.* As passed in the House of Representatives, the National Defense Authorization Act for Fiscal Year 2005 included an income-maintenance provision to replace the lost income of involuntarily mobilized reservists who were experiencing extended and frequent active-duty service. It instructed DoD to pay up to \$3,000 per month to certain service members to make up the difference between their average monthly civilian income and their total monthly military compensation. CBO estimated that the cost of the provision for 2005 would have been \$60 million. Although the proposal would not have affected most civilian employers, self-employed reservists would have been eligible. The provision was removed from the final bill.
- *Guardsmen and Reservist Employer Tax Act of 2003, H.R. 2399.* As introduced in the House of Representatives, this bill would have allowed employers to take a credit against their income tax for reservist employees who were called up. The credit (up to \$25,000 per qualified employee) would have been based on the difference between the reservist employee's average daily qualified compensation and his or her average daily military pay and allowances. A similar credit would have been created for self-employed reservists. The bill did not come to a vote in the House.

Subsidize Loans to Employers. Another option would be to offer subsidized loans to employers. One way to do so would be to improve the availability and effectiveness of the Small Business Administration's MREIDL program. Currently, under the Veterans Entrepreneurship and Small Business Development Act of 1999, small businesses that suffer substantial economic losses because an essential employee (including an owner or operator) is called up during a period of military conflict may apply for a Military Reservist Economic Injury Disaster Loan, which is a working-capital loan designed to be used to pay certain expenses that could not otherwise be paid (such as payroll, fixed debts, and accounts payable) until the reservist is able to return to the business and the firm's normal operations are resumed. To qualify for a loan, an applicant must be a small business or small agricultural cooperative and must demonstrate the harm that the re-

servist's call-up is having or will have on the firm's finances.⁵⁶ An applicant may borrow up to \$1.5 million at an interest rate of 4 percent or less with a maximum term of 30 years. Repayment generally begins about four months after the reservist is deactivated. Since the first loan was granted in 2001, the program has awarded more than 200 loans totaling \$18 million and averaging about \$87,500.

Several aspects of the loan program may limit the number of businesses that apply for and receive MREIDLs or may delay a firm's receipt of funds:

- Eligibility is restricted to businesses that cannot secure sufficient credit elsewhere.
- The loans are available only to small businesses (and small agricultural cooperatives) and only during a period of military conflict.
- A business may not apply for a loan until the reservist is ordered to active duty, so the loss of the reservist may occur before financial assistance is available. Some businesses (particularly those that are owned by reservists) may have difficulty applying for the loan until after the reservist is deactivated.
- Not all potentially qualified employers are likely to know about the loan program, in part because the SBA's direct outreach to them has been limited. Although the agency provides information about the loan program through its Web site and through various publications and mailings, it markets MREIDLs primarily to reservists, not to employers. Reservists receive information about the loans at mobilization sites and through demobilization kits. Thus, while self-employed reservists may be aware of the program, other eligible employers' awareness may be more limited.

Various suggestions have been made about how to re-structure the MREIDL program to provide more-flexible, timely loans to a larger proportion of reservist employers. Some additional features might include approving loans prior to a reservist's call-up, adding revolving lines of credit to the loan portfolio that firms might use once the reservist was activated or received notice of activation, or linking the loan program to assistance in business plan-

56. As defined in 13 CFR part 121.

ning. Also, the loans' availability could be enhanced by allowing them to be made when no military conflict was occurring and by permitting employers that had other non-SBA financing options to qualify for the loans. But to keep the program focused on the firms that were the most affected, eligibility could still be made contingent on demonstrating financial damage from an expected or actual call-up.

The primary benefit of an expanded loan program is that more employers would be able to spread the losses they incurred from a reservist's absence over an extended time frame and make up such losses at a lower cost than they would otherwise have paid. Because businesses would be better able to cope with such absences, employers would be more likely to support their reservist employees. Another advantage is that a loan program could be targeted toward businesses that encountered financial problems; businesses that could absorb the costs of a call-up would not qualify for a loan.

The effects of this option on DoD and on employees would be much the same as the effects of the previous option (direct payments to employers). If mechanisms were developed so that DoD faced the costs of subsidizing the loans, it would bear more of the costs of a mobilization and so be motivated to make more-efficient decisions about labor resources. Employees might benefit if their employers were more likely to support their reservist activities, knowing that the disruption to the firm would not be as severe. That support could in turn help in DoD's recruiting and retention of reserve forces.

Relying on an expanded MREIDL program has drawbacks, however. First, a loan would help the recovery of firms that employed reservists or that were owned by one, but it would not prevent financial losses nor fully compensate for them. In that respect, it might provide less assistance than a direct payment or tax credit. Second, a loan program might not assist the firms that were most injured: those businesses might not qualify for a loan because they lacked the capability to pay it back. Third, verifying the extent and cause of a firm's financial damage might be difficult and costly. If loan administrators could not accurately determine the losses from call-ups, SBA loans might become available to some firms that were seeking financing for other purposes but unavailable to other firms that were indeed harmed by reservists' activations. The former would raise the cost of the program;

the latter would mean that the loan program was less effective than it might be in alleviating injuries to firms.

Provide or Subsidize Call-Up Insurance for Businesses.

As another alternative, the federal government—possibly through DoD—could offer or subsidize an insurance plan that would offset the financial costs associated with the activation of an essential employee by spreading the risk of incurring such costs among more employers. (If successful, such a plan could offset the costs to individual employers entirely.) But implementing a fiscally sound—that is, a self-sustaining—program presents substantial difficulties, as DoD's previous experience with a reservist insurance program illustrates. In 1996, the Congress instructed DoD to establish income-maintenance insurance for reservists in response to widespread concern that reserve personnel might see their income drop when they were activated. The insurance, known as Ready Reserve Mobilization Income Insurance (RRMII), promised enrolled reservists a monthly benefit upon mobilization, equal to their purchased coverage, for up to 12 months in an 18-month period. The monthly cost to reservists was \$12 for coverage of \$1,000 per month; maximum coverage was \$5,000 per month. DoD began to offer the insurance to reservists in October 1996.

The RRMII program experienced two significant problems: much lower enrollment than DoD had anticipated and severe adverse selection. Adverse selection occurs when individuals who are most likely to suffer a loss (and collect a payment) disproportionately enroll in an insurance program. The enrollment period for the RRMII program occurred at about the same time that DoD was mobilizing reservists for deployment to Bosnia. Service members who knew that they were shortly to deploy (and consequently be eligible for RRMII benefits) enrolled at much higher rates than did other reservists—with the result that the program's benefit payments were significantly greater than its accumulated premiums. With the program facing insolvency, the Congress terminated it only a little more than a year after its initial offering.⁵⁷

DoD's experience with the RRMII program provides some lessons for the design of a call-up insurance program for businesses. As with RRMII, an immediate issue

57. For a more detailed discussion of the program, see Lawrence Kapp, *The Ready Reserve Mobilization Income Insurance Program*, Congressional Research Service Report 98-652F (August 1998).

is that the fund might be required to pay out significant benefits before it had accumulated significant assets. To illustrate the magnitude of that problem, consider a case in which all private-sector employers of drilling reservists (including nonprofit organizations) purchased coverage of \$1,000 per month for each of their reservist employees. Under the assumption that 100,000 reservists were mobilized (of whom roughly one-half were employed in the private sector), the fund would have an ongoing monthly liability of almost \$50 million. For the fund to remain solvent, each employer would have to pay monthly premiums of about \$120 for each reservist. (The premiums would be scaled in proportion to changes in the number of reservists mobilized.) Alternatively, policymakers could choose to set lower premiums and then appropriate start-up funds to "seed" the program.

Another consideration in designing a call-up insurance program for employers of reservists (including reservist business owners) is adverse selection. Employers that were aware that they employed reservists would have at least some information about the likelihood that their reservist employee would be mobilized, and those facing a greater risk of losses from a mobilization would be more likely than those facing a lesser risk to purchase the insurance. Adverse selection would be greatest, however, among the self-employed because they would obviously have advance knowledge of their intention to volunteer for active duty. The problem of adverse selection could be mitigated by determining premiums based on anticipated activation rates and the degree of adverse selection. It could also be lessened by requiring a waiting period before coverage became effective—which would eliminate the problem of firms' enrolling after learning of a pending mobilization.

An advantage sometimes cited for an insurance program is that it could reduce the losses that employers experienced when reservists were activated while protecting reservists' civilian employment. If the benefits that employers received translated into more support for reservists, individuals who no longer faced uncertain prospects in their civilian employment might be more willing to join and stay in the reserves at the current level of military compensation.

The effects of such a program on DoD would be similar to those of the other options. If DoD was responsible for the costs of subsidizing the insurance program, it would

bear more of the cost of reservists' call-ups. And as its costs for the reserves increased, it would face a stronger incentive to use the military's active-duty service members more intensively and its reserves less intensively.

Besides the difficulty of crafting a financially sound program, offering call-up insurance to employers would have other disadvantages. First, it would not help all employers that might be affected by reservists' mobilizations. For example, not all such employers know that they employ reservists. (Some reservists take annual leave when they fulfill their normal training requirements and may not disclose their reserve status to their employer.) Consequently, employers may underestimate the risk of an employee's being called up and be unlikely to purchase insurance. Second, depending on how the program was set up, the cost of administration could be substantial. The provision of insurance is not a so-called core competency of DoD's; thus, such a program might be more costly for the Defense Department to administer than if it established a program through private insurers.

Exempt Certain Reservists from Call-Ups. Another means by which the federal government could help the employers of reservists would be to limit the call-ups some reservists experience. One way to do that would be to allow businesses to claim a hardship waiver and request that an individual or position be exempt from active duty. (In evaluating those claims, DoD could work with other federal agencies that have expertise in small business matters.) An advantage of that alternative would be that the number of waivers could be limited: they would be available only to employers that were likely to experience significant losses from a call-up. Consequently, this option would help firms that most needed help, yet still provide reservists, through USERRA, with a wide range of employment protections. In regard to the Defense Department, this approach might have little impact on DoD's recruiting and retention efforts.

Certain disadvantages apply to that kind of hardship waiver, however. Determining case by case whether an employee or position should be exempt from activation could be difficult and time-consuming. Moreover, if the waiver exempted individuals rather than positions, employers who were unaware of their employee's reserve status would not apply. Indeed, for reservists who wish to be called up for active duty, this approach would be an incentive to hide their reserve status until their mobiliza-

tion orders were received. As a result, the reservist's employer would have little time to plan for the individual's departure.

Another alternative for exempting individuals from mobilization would apply mainly to self-employed reservists. During the annual screening that DoD conducts to ensure the immediate availability of personnel for active duty, the department could require self-employed reservists to submit a business plan demonstrating their ability to withstand a lengthy call-up. Individuals who were un-

able to mobilize for lengthy periods without hardship could be transferred to the Standby Reserve. One advantage of such an approach is that fewer businesses headed by self-employed reservists would experience losses from lengthy activations; another is that its impact on the military's recruiting and retention would probably be small. A disadvantage of this alternative is that the program would be very limited and would not help most businesses that were affected by call-ups. In addition, its administration would add modestly to DoD's costs.



Appendix: Reservists' Protections Under Federal Law

The Uniformed Services Employment and Reemployment Rights Act of 1994

The Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) grants reservist employees broad job protections from which no employer is exempt. The law significantly expanded the employment and reemployment rights granted under its predecessor, the Veterans Reemployment Rights Act of 1940.

Eligibility

Generally, reservists are entitled to the reemployment and employment rights and benefits provided by USERRA if they:

- Leave service under honorable conditions;
- Serve less than five years of cumulative active duty while with an individual employer (some duty, including annual active-duty training and call-ups resulting from a domestic emergency or war, is exempt from the five-year limit);¹
- Give their civilian employer advance notice, either written or verbal, of voluntary or involuntary call-up to active duty; and
- Report back to work or apply for reemployment in a timely manner. Service members who have been on active duty for less than 31 days must report to their employer at the next regularly scheduled work period following their completion of service. Reservists who serve more than 180 days must submit an application

1. Secretaries of the military departments individually determine whether voluntary duty after September 11, 2001, is exempt from the five-year limitation. To date, the Army has exempted voluntary duty when service in support of the war on terrorism exceeds 24 months. The other services have exempted all voluntary duty in support of the current partial mobilization.

for reemployment no later than 90 days following the completion of their period of service.²

Discrimination and Retaliation

Employers are prohibited from denying initial employment, reemployment, retention, promotion, or any other benefit of employment on the basis of membership or service in, application for membership or service in, or obligation to serve in the uniformed services, including the reserves. Employers may not take any adverse employment action against an employee who has exercised a right or enforced a protection under USERRA or who has testified in a proceeding or assisted an investigation under the law.

Reemployment Protection

Reservists whose absence from a position of employment is necessitated by reason of service in the uniformed services are entitled to reemployment rights under USERRA, with distinctions based on the period of service.

A reservist whose period of service was less than 91 days is entitled to be reemployed in the position he or she would have occupied with the employer if continuously employed, the duties of which the reservist is qualified to perform. A reservist whose period of service was for more than 90 days is entitled to be reemployed in the position he or she would have occupied with the employer if continuously employed—or a position of like seniority, status, and pay—the duties of which the reservist is qualified to perform. A reservist who has a disability that was incurred during or aggravated by his or her service and who is not qualified, because of the disability, to perform the duties of the position he or she would have occupied

2. Certain exemptions to those requirements exist. See Pub. L. 103-353, codified at 38 U.S.C. §§4301-4333, for the text of USERRA.

with the employer if continuously employed, is entitled to any other position equivalent in seniority, status, and pay, the duties of which the reservist is qualified to perform.

Reservist employees are entitled to the seniority rights and benefits that they had on the date they left employment for service in the uniformed services and to any additional seniority benefits and rights they would have attained if their employment had been continuous.

Employers may not require reservist employees to use vacation, annual, or similar leave to fulfill their military obligations.

Reservists who are activated are deemed to be on furlough or on leave of absence during their period of service. They are entitled to rights and benefits not determined by seniority that are provided by the employer to other employees of similar seniority, status, and pay who are on furlough or leave of absence.

Except for cause, an employer is prohibited from discharging a reservist reemployed under USERRA within one year after reemployment if the reservist's period of service was more than 180 days or within 180 days after reemployment if the period of service was more than 30 but less than 181 days. Under certain circumstances, such as undue hardship for the employer, the law does not require the employer to rehire the returning reservist.

Health and Pension Benefits Protection

Employees covered under employer-sponsored health plans may elect to continue coverage for up to 24 months during absences for service in the uniformed services. If the employee elects to continue coverage, the employer must continue to pay the employer's portion of the premium during service of 30 days or less, but for service exceeding 30 days, the employee may be required to pay up to 102 percent of the premium, which includes the employer's portion, the employee's portion, and some administrative costs.³ If the employee elects to discontinue the health plan or the coverage is otherwise properly terminated, employees are entitled to immediate reinstatement of the employer-sponsored health care coverage upon reemployment.

3. Reservists automatically have comprehensive health care coverage through the military health care system (TRICARE) when they are ordered to active duty for more than 30 days. Their families are also eligible for TRICARE from the first day of the reservist's active-duty service if his or her orders exceed 30 days.

ment of the employer-sponsored health care coverage upon reemployment. Upon reinstatement, no exclusion or waiting period may be imposed if one would not have been imposed had the plan not been terminated. The prohibition does not apply to coverage of any illness or injury determined (by the Secretary of Veterans Affairs) to have been incurred in or aggravated by the performance of service in the uniformed services.

The right to pension benefits of an employee reemployed under USERRA is protected. The period of service is not treated as a break in service with the employer that maintains the plan; rather, it is considered service with the employer for purposes of determining accrued benefits and their nonforfeitarility. The employer is liable to the plan for funding any obligation to provide benefits and must allocate the employer's contribution for the reemployed service member to the same extent that the allocation occurs for other employees. The reemployed service member is entitled to accrued benefits that are contingent on the employee's contributions only if the employee makes contributions. The payment cannot exceed what the employee would have had to make if employment had been continuous. The period for making the payment is three times the duration of the period of service but cannot exceed five years.

Complaints and Enforcement Procedures

A person who is entitled to protection under USERRA and who believes that his or her employer refused or failed to comply may file a complaint with the Secretary of Labor, through the Veterans' Employment and Training Service (VETS). VETS will investigate and make reasonable attempts to resolve the complaint. If it cannot be resolved, a service member whose employer is a state or a private employer may request that the complaint be referred to the U.S. Attorney General. The Attorney General may file a civil action in U.S. District Court on behalf of the service member.⁴ Service members employed by federal executive agencies may request that the complaint be referred for litigation before the Merit Systems Protection Board. Service members may also initiate private civil action against their employers.

As remedy, the court or the board may require the employer to comply with the provisions of the law, may

4. A political subdivision of a state is considered a private employer for purposes of this law.

award compensation for lost wages and benefits (courts may award an equal amount as liquidated damages if the state's or private employer's actions were willful), and may award attorneys' fees and other litigation expenses.

The Servicemembers Civil Relief Act of 2003

The Servicemembers Civil Relief Act of 2003, which replaced the Soldiers' and Sailors' Relief Act of 1940, provides a variety of protections for members of the uniformed services who are called to military service "to enable such persons to devote their entire energy to the defense needs of the Nation." The full protections afforded service members under the law are not discussed here.⁵ However, the provisions that are described are representative of the protections granted under the law and include provisions that may aid self-employed reservists.

Among other protections, the Servicemembers Civil Relief Act of 2003:

- Grants service members the right to stay court and administrative hearings if military service materially affects their ability to defend their interests. Courts or administrative officials are required to grant one 90-day stay if requested. Additional stays can be granted at the discretion of the judge or official. (§522)
- Clarifies the application of the reduction in interest rates to 6 percent on loans and obligations entered into before the service member began military service. Under the law, annual interest in excess of 6 percent must be forgiven if the service member's request is in writing and accompanied by a copy of his or her orders. This provision is applicable only if the service member's ability to pay is materially affected by his or her military service. (§527)
- Precludes evictions without a court order of a service member's family for nonpayment of rent from rental property occupied primarily as a residence. That provision applies if the rent on the premises does not exceed \$2,400 for 2003; the rent ceiling is adjusted annually by the yearly increase in the November housing component of the consumer price index. (§531)
- Grants the right of a service member to terminate real property leases for residential, professional, business, agricultural, or similar purposes that were intended to be occupied by the service member or dependents, in which the lease is executed prior to a call-up. Installment contracts for the purchase or lease of real or personal property, on which a deposit or installment is paid, may not be terminated or property repossessed for nonpayment or breach during military service, except by court order. (§§535 and 532)
- Permits the termination of a motor vehicle lease on a vehicle used by service members and their dependents. A lease entered into before the service member was called to active duty may be terminated if the activation is for 180 days or more; leases entered into during military service may be terminated if the service member is ordered to a permanent change of station outside the continental United States or is deployed for a period of 180 days or more. (§535)
- Permits service members to maintain their state of residence for tax purposes despite military relocations to other states. Accordingly, military compensation is not "income" in the state of relocation, personal property is not located in the state of relocation, and the state of relocation is precluded from using the military income of a nonresident service member to increase the tax liability of the service member or spouse subject to tax in that state. (§571)
- Provides for the suspension of existing professional liability insurance coverage for health care and legal service professionals who are called to active duty and for the subsequent reinstatement of that insurance once the military service is completed. (§593)
- Provides the right to reinstatement of health insurance that was in effect on the day before activation but terminated during service. No exclusion or waiting period for a condition may be imposed on the reinstatement if the condition arose before or during the period of active duty, if no exclusion or waiting period would have been imposed if coverage had not been suspended, and if the condition is not defined as "a disability incurred or aggravated in the line of duty." This provision does not apply to service members who are entitled to participate in employer-sponsored insurance benefits under USERRA. (§594)

5. For the full text of the law, see Public Law 108-189, codified at 50 U.S.C. App. §§ 501-596.